18

REVIEW OF FARMERS HOME ADMINISTRATION LOAN PORTFOLIOS

HEARING

BEFORE THE

INFORMATION, JUSTICE, TRANSPORTATION, AND AGRICULTURE SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

FEBRUARY 9, 1994

Printed for the use of the Committee on Government Operations

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REVIEW OF FARMERS HOME ADMINISTRATION LOAN PORTFOLIOS

WEDNESDAY, FEBRUARY 9, 1994

HOUSE OF REPRESENTATIVES,
INFORMATION, JUSTICE, TRANSPORTATION,
AND AGRICULTURE SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Gary A. Condit (chairman of the subcommittee) presiding.

Present: Representatives Gary A. Condit, Karen L. Thurman, Bart Stupak, Craig Thomas, and Ileana Ros-Lehtinen.

Also present: Representative Collin C. Peterson.

Staff present: Edward L. Armstong, professional staff member, Aurord Ogg, clerk; and Diane M. Major, minority professional staff, Committee on Government Operations

OPENING STATEMENT OF CHAIRMAN CONDIT

Mr. CONDIT. Good morning.

I would like to begin this morning's hearing with a little background. I initially called this hearing to review the servicing component of section 502 housing. However, in the time in between calling the hearing and today, press reports have focused attention on losses in the farm programs.

These reports prompted several Members to contact the subcommittee to ask if they would have an opportunity to inquire about those reports. Because I greatly value their input, I contacted witnesses from the GAO and USDA to ask them to prepare for some additional questions on this issue. The witnesses agreed to do this and I will extend my thanks in advance of their testimony.

It is very important to not lose sight of the fact that the mission of the Farmers Home Administration is to be a lender of last resort. Because of this, it is not surprising that the program carries a high level of risk.

Today, we hope to get an idea of the extent of our vulnerability to losses in the program. I am also going to take a hard look at how single-family housing loans are being serviced by Farmers Home. A report commissioned by FmHA concluded that centralizing the servicing would result in a savings of $106 million a year.

It seems like the time is right to make that move because of the reorganization USDA. We will be discussing whether it would be

best to contract out the servicing or to do it in-house. If the choice is in-house, I want to know how much it is going to cost.

I also am going to be looking forward to checking the progress on the mortgage escrowing program being developed at Farmers Home.

This is hopefully going to be a constructive dialog today. And we will have other Members joining us a little later.

At this time, I will turn to our ranking minority member, Mr. Craig Thomas, for an opening statement.

Mr. THOMAS. Thank you, Mr. Chairman.

Let me, too, welcome you to this hearing, and thank you, Mr. Chairman, for having a hearing that concerns itself, I think, with efficiency in government, which certainly is something we all ought to be concerned with, as well as delivering the services.

The Farmers Home Administration has tried to serve the needs of rural Americans since 1949 as the lender of last resort. The mission, however, has become a little clouded in terms of duplication, overlapping, maybe outdated resources and systems. So there is considerable discussion about that.

Since 1987, it is my understanding, there has been a mandate to establish an escrow account system for single-family housing borrowers. It is now 1994, and apparently no program is in place.

Since 1990, FmHA has been studying the benefits and advantages of centralizing this service. In September 1992, an external study concluded it could save the $100 million that was mentioned here before and still apparently no action has been taken.

Unfortunately, this is becoming a recurrent theme in FmHA. At a time when the Secretary is proposing reorganization, certainly more studies are not the answer. We need to make some appropriate moves.

Whether services are centralized in-house or contracted, efficiency should be the goal. I must tell you that whenever possible I favor personally the idea of contracting. So I will be very much interested in your comments, and the administration's, in how we can best achieve the downsizing.

Thank you, Mr. Chairman.

Mr. CONDIT. Thank you, Mr. Thomas.

Mr. Peterson, do you have any opening statements? We are delighted to have you with us today.

Our first witness is John Harman, Director, Food and Agriculture Issues for the General Accounting Office.

We have a policy of swearing all witnesses in. I ask you to rise and raise your right hand, please.

[Witnesses sworn.]

Mr. CONDIT. Let the record show they all said "I do."

Mr. Harman, do you want to begin?

STATEMENT OF JOHN HARMAN, DIRECTOR, FOOD AND AGRICULTURE ISSUES, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY ANDREW FINKEL AND ARTHUR BROUK

Mr. HARMAN. Thank you, Mr. Chairman.

We are pleased to be here this morning to discuss a proposal to centralize servicing for the FmHA single-family housing loans. Our testimony is based on a September 1993 report which we did for you and for the chairman and the ranking minority member of the Senate Agriculture Committee.

I would like to introduce my colleagues. On my left is Andy Finkel. He has spent the last 7 or so years looking at ways to improve the management of the USDA. And Art Brouk pretty much has done the same thing in a somewhat different capacity, looking at the financial systems. He has also been heavily involved in our Farmers Home work.

I will be summarizing the prepared testimony which has been provided for the record. The possibility of centralizing FmHA's service activities presents a golden opportunity to demonstrate how reengineering government processes in more businesslike ways can improve service while cutting costs.

Centralizing these activities is consistent with our position that USDA needs to be fundamentally restructured, reinvented, if you will, in the context of the newer management concepts that guide private sector corporations, State governments, and governments in other countries.

These concepts emphasize among other things competition, flattened hierarchies, and achievement of results. In this context, there are three specific points I would like to address this morning, based, as I said, on that earlier report.

The first is that although Farmers Home has studied and demonstrated the benefits of centralized servicing since 1988 as a means to improve program management and streamline its field office operations, it has yet to take action. Over the past 5½ years, as both you and Mr. Thomas referred, studies have been done. We, the government, have spent about $1.6 million for those studies, and there has also been three plans for implementing loan servicing activities and an unsuccessful pilot project to establish federally mandated escrow accounting.

The most recent of the three plans was FmHA's June 1992 strategic business plan, stating the agency would implement centralized accounting in fiscal year 1994. That plan was not carried forward by the new administration because it did not want to develop a business plan developed by the prior administration. A new task force was formed in January 1994 to once again study centralized servicing options.

The second point is that FmHA studies and our analysis show that the benefits outweigh the disadvantages. For example, the contract of USDA study estimated operating savings, as you referred to, of $106 million annually. We identify more than 100 offices that have more than 75 percent of their loans in single-family housing. With centralized servicing, these offices could be studied for possible consolidation or closure.

Other benefits which are currently experienced by the private company that currently services FmHA loans are reduced loan losses. The private company credits this increased efficiency to, one, its computer system that flags delinquent borrowers and allows the company to question early on why payments were missed; two, an escrow accounting system that helps borrowers budget for

taxes and insurance; and three, a high degree of specialization among its staff.

There are some disadvantages that need to be recognized, including a loss of face-to-face contact between the borrower and loan servicer and the cost that would be incurred to redesign automated systems if centralized servicing were to be carried out by Farmers Home rather than a private company already using centralized servicing.

At private servicing companies, the loss of face-to-face contact does not prove to be a major detriment to customer service, and on numerous occasions we reported on the need to improve FmHA's automated systems.

The final point is that the three basic options for moving forward with centralization include in-house loan servicing by FmHA; private sector contracting; or a combination of the two that allows the public and private sectors to compete for the loan servicing. At least to some extent the option selected depends on one's view of the government's role and whether it can carry out and should carry out functions the private sector can do.

In recent literature, efforts by the administration's National Performance Review team have emphasized the benefits of private sector competition. For example, it states, "Reinventing government is not just about trimming programs; it is about fundamentally changing the way government does business. Forcing public agencies to compete will create a permanent pressure to streamline programs, abandon the obsolete, and improve what is left."

Allowing private companies to compete for the borrowers currently serviced at the local level would fundamentally change the way Farmers Home does business. It could also mean reaping the benefits of the competitive marketplace, greater efficiency, increased focus on customer needs, and improved morale.

For example, while Farmers Home has successfully attempted to develop an escrow accounting system, a private company has established escrow accounts for each of its 90,000 loans. Farmers Home will have to develop a computer system that meets the needs of Farmers Home and its employees. Without such a system, it cannot compete.

Any of the three options could operate over the next 3 years. We could rely on attrition and retirement to reduce the work force in those offices that need to be closed.

With that, Mr. Chairman, that concludes my summary and we would be pleased to answer any questions you might have.

[The prepared statement of Mr. Harman follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Information, Justice, Transportation and Agriculture, Committee on Government Operations, House of Representatives

For Release on Delivery
Expected at
10:00 a.m. EST
Wednesday
February 9, 1994

U.S. DEPARTMENT OF AGRICULTURE

Centralized Servicing for FmHA Single-Family Housing Loans

John W. Harman, Director,
Food and Agriculture Issues,
Resources, Community, and Economic
Development Division

GAO/T-RCED-94-121

Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in this hearing on a proposal to centralize servicing for the Farmers Home Administration's (FmHA) single-family housing loans. Our testimony is based on our September 1993 report on the advantages to be gained from centralizing such servicing activities as loan collections, escrow accounting for taxes and insurance, and delinquency management.[1]

In summary, the possibility of centralizing FmHA's service activities presents an opportunity to demonstrate how reengineering government processes in more businesslike ways can improve service while cutting costs. FmHA's efforts over the past 5-1/2 years to centralize servicing operations for direct housing loans have not been fruitful, the budgetary and efficiency benefits of centralization outweigh the disadvantages, and options for moving forward with centralization would be consistent with USDA's efforts to reinvent itself.

Centralizing loan servicing activities is also consistent with positions we took in testimony before this subcommittee in April 1993[2]. In that testimony, we said that the U.S. Department of Agriculture (USDA) needs to be fundamentally restructured--reinvented, if you will--in the context of the newer management concepts that guide private sector corporations, state governments, and governments in other countries. These concepts emphasize, among other things, competition, flattened hierarchies, and the achievement of results.

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[1]U.S. Department of Agriculture: Centralized Servicing for FmHA Single-Family Housing Loans (GAO/RCED-93-231BR, Sept. 23, 1993).

[2] Revitalizing USDA--A Challenge for the 21st Century (GAO\T-RCED-93-32; April 22, 1993).

After providing some brief background, the remainder of our testimony will focus on FmHA's past efforts, the benefits and disadvantages of centralization, and options for moving forward.

BACKGROUND

FmHA makes housing and farm loans to rural Americans who cannot otherwise obtain them on reasonable terms. FmHA has a large single-family housing portfolio. As of December 31, 1993, the outstanding principal due on single-family housing loans was $18.6 billion (compared to about $13.7 billion for farm loans), and the ratio of direct single-family housing borrowers to farm program borrowers was 3 to 1. Moreover, since the program was first authorized in the Housing Act of 1949, FmHA has made over 2 million single-family housing loans for over $45 billion.

FmHA services about 675,000 single-family housing borrowers from about 1,700 offices. Servicing these single-family housing loans accounts for about 35 percent of the work load in FmHA's county offices. An additional 90,000 loans are administered by a loan servicing company from a central location. These loans were sold in 1987 as part of the Omnibus Budget Reconciliation Act of 1986.

The private sector has used centralized servicing of housing loans for many years. Under centralized servicing, an individual who wishes to buy a home obtains a loan from a lending institution. After the loan is closed, the lending institution often sells the servicing rights to another organization. It is this centralized servicing organization that collects monthly payments, establishes escrows for property taxes and insurance, manages delinquencies, and provides credit counseling. The borrower communicates with the servicing organization over the telephone or through the mail.

FmHA's in-house centralized servicing for FmHA borrowers would work in much the same way as private sector servicing. Borrowers could obtain their loans from FmHA's local offices, regional offices, or a central location, but all loan servicing would be performed at a separate, central location. The borrower would receive the same services provided by the private sector loan servicing industry as well as services unique to FmHA, such as periodic review of interest credit agreements, application of moratoriums, and appeals.

Although Many Studies Support Centralized Servicing, No Action Has Been Taken

Although FmHA has pursued the centralized servicing concept since 1988 as a means to improve program management and streamline its field office operations, it has yet to take action. Over the past 5-1/2 years, FmHA has spent more than $1.6 million for one external and two internal studies, three plans for implementing centralized loan servicing, and an unsuccessful pilot project to establish federally mandated escrow accounting. The pilot project did not succeed because the contractor was not able to integrate its automation system with FmHA's loan accounting system.

The most recent of the three plans was FmHA's June 1992 Strategic Business Plan, which stated that the agency would implement centralized servicing and escrow accounting by fiscal year 1994. That plan was not carried forward by the new administration because it did not want to deal with a business plan developed by the prior administration.

A new FmHA task force was formed in January 1994 to once again study centralized servicing options.

Benefits Outweigh the Disadvantages of Centralization

FmHA's studies and our analysis show that the benefits of centralized servicing outweigh the disadvantages. For example, a contracted USDA study estimated operating cost savings of $106 million annually. Moreover, we identified about 700 FmHA county offices that have more than 75 percent of their loans in single-family housing. With centralized servicing, these offices could be studied for possible consolidation or closure. Other benefits of centralized servicing--which are currently experienced by the private company that centrally services the former FmHA single-family housing loans--are an appreciably lower delinquency rate (9.2 percent on December 31, 1993, vs. 16 percent for FmHA) and reduced loan losses. The private company credits this increased efficiency (as compared to FmHA's servicing) to its (1) computer system that flags delinquent borrowers and allows the company to question early on why payments were missed, (2) escrow accounting system that helps borrowers budget for taxes and insurance, and (3) high degree of specialization among staff members who service loans.

The potential disadvantages of centralized servicing are (1) the loss of face-to-face contact between borrower and loan servicer and (2) the costs that would be incurred to redesign automated systems, if centralized servicing were to be carried out by FmHA rather than by a private company already using centralized servicing. At private servicing companies, the loss of face-to-face contact has not proved to be a major detriment to customer service, and on numerous occasions we have reported on the need to improve FmHA's automated systems.

Options for Moving Forward With Centralization

Three basic options for moving forward with centralization include in-house loan servicing by FmHA, private sector

contracting, or a combination of the two that allows the public and private sectors to compete for the loan servicing. At least to some extent, the option selected depends on ones's view of the role of the government and whether it can carry out and should be carrying out functions the private sector can do.

Although this is an age-old debate, recent literature and efforts by the administration's National Performance Review team have emphasized the benefits of private sector and public/private competition. For example, the National Performance Review states that

> "reinventing government is not just about trimming programs; it's about fundamentally changing the way government does business. Forcing public agencies to compete...will create a permanent pressure to streamline programs, abandon the obsolete, and improve what's left."

Allowing the public and private sectors to compete for centralized servicing of the 675,000 borrowers currently serviced at the local level will fundamentally change the way FmHA does business. It also could mean reaping the benefits of the competitive marketplace--greater efficiency, increased focus on customer needs, increased innovation, and improved morale.

For example, while FmHA has unsuccessfully attempted to develop an escrow accounting system for the loans it services, a private company has established escrow accounts for each of its 90,000 loans. If forced to compete, FmHA will have to develop escrow accounts and a computer system that meets the needs of the loan holders and FmHA employees. Without a system comparable to the one developed by private industry, FmHA would not be competitive. Yet the literature states that once forced to compete, government employees enjoy the challenge of competition if job security is not at stake.

Any of the three options could be implemented over a period of years. This measured pace would allow USDA to rely on attrition and retirements to minimize reductions in the work force that would result from office consolidations.

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That concludes my statement. I would be happy to respond to any question you may have.

Mr. CONDIT. Thank you.

Do either of you gentlemen have statements?

Thank you very much.

It is my understanding you have prepared an update on the Farmers Home program losses. I will hold the record open so can you insert whatever information you wish. So I would appreciate it if you can give me a summary on how the new information compares with the report you published in April 1992.

Mr. HARMAN. This deals with the farm loans' side of it.

Mr. CONDIT. Correct.

Mr. HARMAN. In April 1992, we published a fairly comprehensive report on the Farmers Home programs. What has happened since then? I guess there is some good news and bad news. The good news is that the delinquency rate is down. It is at about 22 percent for direct loans and 18 percent of the total portfolio.

The bad news is the reason it is down is because those loans have for the most part been written off as losses. In that sense they do have a lower figure—the delinquency rate is going down. But the other bad news here is we are still making loans. Farmers Home is still making loans to delinquent borrowers. Our work in the new report indicates that is still happening.

Mr. CONDIT. So the improvement, which looks good on paper, is purely based on the fact that they are writing off the bad debt?

Mr. HARMAN. That is correct, for the most part.

Mr. CONDIT. You wrote a report for this subcommittee 2 years ago that stated that the debt relief action for business entities borrowers were very questionable. And this is a two-part question. Does this problem expand beyond business borrowers, and does it still persist?

Mr. HARMAN. Yes. The systems that Farmers Home has had to assure that they are both making good loans and servicing those loans, has just not worked. Again, I am talking about the farm loans. The internal controls we have had across the board, whether business entity borrowers or any other type of borrower.

That is not altogether, as we pointed out in the 1992 report, the fault of Farmers Home. They have been given a job that has been very difficult to fulfill, and legislation has sometimes been inconsistent about what their overall mission is. The mission swings from one that looks at financially protecting the taxpayers' interests to more of a social program. Our view is that program has swung entirely too far toward the social benefits and away from the taxpayers.

Mr. CONDIT. I am going to move to some housing questions. I understand there are some Members interested in asking you some additional farm loan questions. Could you outline the efforts the USDA has made to study the possibility of possibly implementing centralized services and mortgage escrowing?

Mr. HARMAN. I will just briefly give you an overview. As I said in my prepared testimony, FmHA has had a number of studies done which indicates the benefits of centralization.

They have also, of course, had the requirements over the last 5½ years, when the Congress implemented and passed the legislation to set up an escrow accounting system. They have run into many difficulties in doing that.

Let me ask that either Andy or Art address that. I think they have some details they can provide to you.

Mr. CONDIT. Sure.

Mr. FINKEL. Basically they have done three studies over that 5½ year time period, and they just started a new task force to again look specifically at the escrow question. From what I understand, they now believe they will be able to have escrowing going in about 2 years.

Mr. CONDIT. Do you agree with the finding from the IBC report that the USDA should move to centralized service in-house, servicing in-house?

Mr. HARMAN. Not necessarily. I think there are some benefits to be gained by the competition. Farmers Home has a long way to go to get to the point where they can do this centrally, mainly because of problems with their accounting systems and problems with their computerized information systems.

If you had to make a decision today, I don't think there would be any question that right now the private side would have a distinct advantage. If you try to make this a competitive situation, Farmers Home would just not be able to compete.

Mr. CONDIT. What about the issue of Farmers Home's face-to-face contact with the borrowers? Would losing this lead to an increase in the default rate?

Mr. HARMAN. I don't believe that is necessarily the case. All of the issues revolve around servicing the customer in terms of providing him financial advice and counsel such as what type of loans are available. A lot of that can be done up front.

Our experience, particularly in the farm loans—we haven't done a lot of work on the housing side of this—but on the farm loans, that type of customer servicing, is just not being done.

You are bringing in a borrower that is already 85 percent or so leveraged, who may or may not have the wherewithal to be able to make the kind of financial decisions, and Farmers Home just hasn't been able to put the resources in to do that kind of service. So it is not happening now, and to my understanding it is not happening to a great extent at the local level.

So if they are going to keep servicing at the local level, that is going to take up the time of the people to serve the customer and give him the kind of information and assistance they need to get out of the financial bind that they are in.

Mr. CONDIT. Do you agree with Farmers Home's view that the loans sold to the Chemical Bank were the cream of the crop?

Mr. HARMAN. No, we don't agree necessarily with that, either. We don't know if they were or weren't. The information systems don't give the kind of historical information—you almost have to go back to the individual loan files to find out each loans history—FmHA rewrites these loans often. The loans were current at the time they were bought by the private sector, but many had just been restructured. Therefore there is no indication that they necessarily are the better loans. We just don't know.

The information is not there.

Mr. CONDIT. Do you today or will you have in the next few weeks any recommendations as to how Farmers Home will implement an escrowing system?

Mr. HARMAN. No, we haven't looked at that question. And Art, you may want to talk about that just briefly.

Mr. BROUK. One thing they may want to check out is what is already available in the private sector. I think we note in our testimony that the same loans that Farmers Home is servicing right now are being serviced in the private sector with an escrowing system. That may be one way to get the technology and not reinvent the wheel.

Mr. CONDIT. Is there a lot of startup cost involved in doing that?

Mr. BROUK. I would think there is a lot of startup cost in escrowing because you are essentially dealing with just about every county in the United States and just about every taxing authority. It would take quite a bit of work to get going and put that all together. You are probably dealing with thousands of insurance companies also.

So there is a lot of software to develop there.

Mr. HARMAN. And as you know, from this committee's oversight of Farmers Home and USDA's efforts in developing computer systems, it has not been one of complete success.

There is a lot of discipline involved in developing systems; and this would certainly have to be brought to bear in developing this kind of a system. I think it is really uncertain about how long it would take.

Mr. BROUK. Also, Farmers Home has a lot of other system priorities. It would be questionable how high a priority this would get among the other development projects that they have.

Mr. CONDIT. Mr. Harman, the annual OMB high-risk list states that the USDA missed, lost, or misapplied budget resources due to unreliable budget management; would you agree with that?

Mr. HARMAN. Definitely. I think there is a tremendous lack of management information necessary to make the basic day-to-day management decisions they need to make.

Mr. CONDIT. Mr. Thomas.

Mr. THOMAS. It is an interesting topic. I suppose in the broadest sense you should start by analyzing the program and saying, do we need to do it, and second, who should do it, and then how do you best do it.

There are a number of agencies who do similar things, are there not?

Mr. HARMAN. That is correct. I don't know if there is that many that do direct lending. There are a number of Federal agencies particularly that guarantee loans Fannie Mae, Ginnie Mae, those type of agencies, even Farmers Home.

Mr. THOMAS. But they do have involvement in this area, and I presume have a system set up to track the guarantees that they have, right?

Mr. HARMAN. That is correct.

Mr. THOMAS. Is there any change there of technology and so on, for how to do these things?

Mr. HARMAN. Not that I know of. Those agencies are not involved in servicing, because they are just involved in guaranteeing the loans.

Mr. THOMAS. This is a broader thing. Why don't they use the secondary market? Why do we keep these loans?

Mr. HARMAN. For the most part because the secondary market wouldn't buy these loans. They are pretty much worthless. At least I am talking about the farm loans now.

Mr. THOMAS. We are not talking about farm loans, though.

Mr. BROUK. The housing loans would still be considered high risk because they can only come to Farmers Home after they have been turned down by other sources of credit.

Mr. THOMAS. You say obtain them at reasonable terms.

Mr. BROUK. Right. So if they go to the local bank and if the bank will not give them a loan at a reasonable term, they can come to Farmers Home. But these are primarily low-income borrowers that are getting these loans.

Mr. HARMAN. That is what the program is. There is nothing necessarily wrong with that. We are not talking about a program here that is set up to give creditworthy borrowers credit and then try to sell it on the secondary market.

Some of this was done. We haven't done any work on it for several years, but there were some problems in trying to sell Farmers Home loans to Farmer Mac on the secondary market. I don't have any current information on what the status of that might be.

Mr. THOMAS. Centralizing is not a new idea, is it?

Mr. HARMAN. No, it is not. The big question here is—and it gets back to your original statement—what are you trying to do and how are you going to do it.

There are certain functions and activities that make sense to have at the local level and they work very well at the local level. There are others that make better sense to centralize.

Mr. THOMAS. We have been through a number of these things where agencies have been responsible for tracking and monitoring and indeed investing large sums of money, and typically haven't done particularly well at that. Is that a fair statement?

Mr. HARMAN. In my experience in dealing with these information systems, these computer systems, that is a fair statement.

Mr. THOMAS. BIA, for example.

Mr. HARMAN. Yes. The government across the border has not done well in bringing up computer systems. There are ones that——

Mr. THOMAS. Why is there then or is there resistance to using this as a function of the private sector on some kind of a contracting bid basis?

Mr. HARMAN. Well, I think you are dealing with the process of change here, and when you are dealing with change, you have perceived winners and losers. A lot of people out in these county offices, as well as people in headquarters, perceive they will come out as losers. Anyhow, they foresee a different way of doing things. Whenever you have that, you are going to have resistance.

Mr. FINKEL. There are also perceived gains. About 35 percent of the resources in these county offices is spent servicing these housing loans. If you can centralize this operation, you are freeing up a lot of resources that could be doing the types of loan origination and problem loan followup face-to-face contact that Farmers Home is looking for.

Mr. THOMAS. Isn't there a proposal to sort of put together into a servicing office an ACSC and Farmers Home?

Mr. HARMAN. Single farm agency and—yes. I guess my answer to that would be that restructuring and reorganization doesn't necessarily mean reengineering.

Mr. THOMAS. I understand that. On the other hand, when you are doing that, it seems like a great time to look at doing something else if it in fact has merit.

Mr. FINKEL. They are also talking about splitting Farmers Home into—two or a portion into the farm service agency, and another portion into a rural development kind of operation.

We identified 700 offices where, 75 percent or more of the portfolio is housing loans. It would make sense to put these offices on the rural development side of the operation.

Mr. THOMAS. I see. Well, I appreciate your being here, and your comments. I am impressed, as a matter of fact, with your forthrightness. I have to say that the general accounting folks do not always have as specific ideas as you do.

Time and time again, we talk about the problems, but at some point, you have to do something about it, and what is your recommendation?

Mr. HARMAN. We have, and we have got a great deal of work behind us, particularly on the farm loan side. The problems are not easily solved. I mean, some of them have to do with making sure that that agency understands exactly what their mission is by Congress. So some of the action has to be taken up here.

Mr. THOMAS. Congress has been very good at clarifying things.

Mr. HARMAN. Right. And bringing the agency in to operate on a more businesslike way. I have met with the new Farmers Home Administrator, and I have to say I am at this point optimistic at least. Being in this for 9 years now—actually January 1, 1985, is when I started working in this agriculture area—and this is the kind of things he is talking about trying to do, stepping back and trying to make FmHA run a more businesslike way. He has a hard job.

Mr. THOMAS. Thank you, sir.

Thank you, Mr. Chairman.

Mr. CONDIT. Thank you, Mr. Thomas.

Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman. I have got a couple of questions. You said that they are continuing to make loans to delinquent borrowers?

Mr. HARMAN. That is correct.

Mr. PETERSON. Why are they doing that? Did you ask them?

Mr. HARMAN. I might bring Pat Sweeney up here, who has been in this area as long as I have, to answer some of that.

Mr. PETERSON. Are these direct——

Mr. HARMAN. These are direct loans. And it has been something that Congress has encouraged over the years, quite frankly. Whenever they have tried to tighten up and not make those types of loans, they have been brought on the carpet. And a lot of this occurred during the 1980's when there was a lot of stress on farmers.

Mr. PETERSON. So your statement related to what happened in the 1980's, all the pressure from the farm crisis and so forth——

Mr. HARMAN. Yes, I think that is part of it, and there has been a real emphasis on the social side of the equation. We have a lot

of farmers here that simply are going to be on these rolls, and we are going to have to just bring them off.

Mr. PETERSON. So what you are really saying is that Congress basically forced this more than the agency?

Mr. HARMAN. It is a combination of things. I think all three branches got involved in this. We had moratoriums that affected it. The moratoriums came about because Farmers Home wasn't doing its job.

Mr. PETERSON. It is pretty hard for us to criticize them for not being businesslike when we are basically telling them they can't be businesslike.

Mr. HARMAN. I would agree with that.

Mr. PETERSON. This does not include dumping bad loans into—taking bad loans that the banks have, for example, and guaranteeing them?

Mr. HARMAN. No, that has been a concern of ours.

Mr. PETERSON. Have you looked at that?

Mr. HARMAN. Yes, we are doing some work on it currently. There has been a good deal of that going on, where the banks would take loans that were questionable and use the guarantee program.

When we first started testifying on the guarantee program, we had similar concerns as with the direct program. We saw a lack of internal controls and good management. It seems as though the loss experience there has not been nearly what it was in the direct program, so it may be that that 10 percent that the banks have invested is enough to make them exercise good financial control over the loans.

Mr. PETERSON. They are not making any direct loans anymore, are they?

Mr. HARMAN. Not very many. They are making direct loans, but——

Mr. PETERSON. There is not as much money there?

Mr. HARMAN. Not as much as there was. There used to be $1 billion. Now, it is about $600 million.

Mr. PETERSON. When you did this investigation, you didn't look at specific individuals, you just looked at the big picture?

Mr. HARMAN. Well, no, we have looked at individuals. We started this in 1985, and we have issued 30 or so reports on all aspects of Farmers Home farm loan programs.

The 1992 report was sort of an overall case study type analysis to demonstrate some of the problems of people that get a loan—how they are serviced, why they become delinquent, how they are serviced again. I mean, they are on a treadmill where their equity is eaten away and we start questioning, is that what Congress intended when they set up this program.

Mr. PETERSON. Some of these people would have been a lot better off if we had put them out of their misery. They would at least have some equity.

Mr. HARMAN. That was our point.

Mr. PETERSON. How did the Washington Post figure out who these people were? My people have tried to figure this out and I have tried, and you can't get that information. How did they get it?

Mr. HARMAN. I have no idea where they got that information.

Mr. PETERSON. You don't?

Mr. HARMAN. No, I don't. I know we talked to the reporter on several occasions, but I don't even know if we——

Mr. PETERSON. They have got one list, and they got another list, and matched them up or something. Does anybody know how they did that?

Mr. CONDIT. Does anyone in the room know how they did that?

Mr. HARMAN. There are always ways, I guess, if you are tenacious enough.

Mr. PETERSON. But that information is not available in——

Mr. HARMAN. No. They certainly didn't get it from us. I don't even know if we had that information. If it was available to us, we would want to find it out.

Mr. PETERSON. Congress can get a hold of that information?

Mr. BROUK. It is in the Farmers Home data base. Most Farmers Home employees could get it.

Mr. PETERSON. But individual Members of Congress can't get it. I have tried.

Mr. BROUK. That may be true.

Mr. PETERSON. Thank you, Mr. Chairman.

Mr. CONDIT. Thank you, very much, Mr. Peterson. I appreciate your being here this morning. Mrs. Thurman. Mr. Stupak. Mr. Harman, I appreciate your testimony very much, thank you.

Next is Michael Dunn, Farmers Home Administration.

[Witnesses sworn.]

Mr. CONDIT. Thank you very much. Mr. Dunn, the floor is yours. I appreciate your patience in working with us and your help on expanding the issue today. We appreciate that very much.

STATEMENT OF MICHAEL V. DUNN, ADMINISTRATOR, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY TOM HANNAH AND RON THARRINGTON

Mr. DUNN. Thank you very much, Mr. Chairman. I appreciate the indulgence of you and the subcommittee in working with us on this most important matter. I commend you and the subcommittee for looking at these particular matters.

I have with me Mr. Tom Hannah and Ronnie Tharrington who will assist me in the testimony today. And Mr. Chairman, I apologize for the lateness of submitting my testimony to you and the subcommittee. I have had some technical difficulties, as we might say, and I would like to submit a corrected copy, with your indulgence.

First of all, Mr. Chairman, I think it is important that we understand what Farmers Home Administration is about, and the clientele that we have. Farmers Home Administration was designed to serve supervised credit for rural America for the most needy people there. That means meeting mandates, and we have to meet mandates created by budget deficits to continue to reduce the costs of government.

Our typical loan in rural communities is to the very, very lowest of low income people. Medium income for rural America is around $27,000. The average adjusted income of a Farmers Home single

family borrower is $16,700. We could qualify a person for a home with income below $8,450.

So we have a very, very selected clientele we provide loans to. In addition, those loans can be made with no down payments.

I would like to also point out at this time, Mr. Chairman, that we have submitted a single-family housing loan program, which is under discussion today, that has been selected for a pilot program under the Government Performance and Results Act. Under that, a task force of representatives from the Department of Agriculture and the General Accounting Office have recommended consideration of the performance of this loan portfolio by input measures such as employee expertise, loan making and servicing cost, credit reform, subsidy rates; process measures such as customer outreach and education time, and process loan application and appeals time; and output measures, such as the number of loans made, funds obligated, loans by race, income, gender, housing inventory, as well as outcome measures such as the success of the homeownership loan delinquencies, graduation to other credit, inventory housing leased for use by the homeless, and loan writeoffs, among others.

Having the Government Performance and Results Act, and having this program selected as a model for that act, is going to establish some criteria, Mr. Chairman, that you and Farmers Home Administration will be able to judge the agency by. We have some 680,000 loans serviced by individual county offices. What we are here today to talk about is the most efficient way to do it.

There has been some talk about escrowing, and we were mandated by law to establish escrowing servicing. I was sworn in on November 30. One of my first acts was to ask the staff to proceed with developing that escrowing procedure, and we are going to be able to talk about that today, of where we are and what we intend to accomplish.

By all accounts, this costs the agency approximately $20 million a year. Mr. Chairman, as the previous witness has indicated, there are problems in this agency. There are problems in the way this agency makes loans and services loans. And there are tremendous problems as a result of ineffective, I would say almost dysfunctional accounting and communications systems within the agency.

Mr. Chairman, the Clinton administration has vowed to reinvent government. We have a National Performance Review that has come up with a number of recommendations that we hope to implement in the Farmers Home Administration to do that.

As I talk about the problems we have out there, I think it is no secret to you or other members of this committee that our accounting system is outdated, inefficient, extremely expensive to maintain, and, frankly, we do not meet the needs of either the agency or the public we serve with that accounting system.

Mr. Chairman, we are spending approximately $20 million a year to maintain this accounting system that does not serve us.

We can no longer afford to continue down this same path. Better training of personnel, revised regulations, and additional servicing legislation can only go so far. We cannot make dramatic improvements of our supervised credit efforts without also making dramatic improvements in our automated processes and financial accounting systems.

We must develop a comprehensive strategy for addressing our automated needs, and we must start as soon as possible. But we must have the means for financing such an enormous undertaking.

Mr. Chairman, I would submit for your consideration that this committee look at what is currently passing through Congress at the present time, H.R. 3400. In that bill that has been passed by the House, it allows agencies to meet performance standards by utilizing some of the moneys that they collect from delinquency accounts, et cetera, and plowing them back in to upgrade their systems.

I believe that that mechanism is a means we should look at to help Farmers Home Administration to get the systems that we need. And we would work very closely with you and the committee on any types of recommendations that you might have in that area.

We are going through a restructuring. Secretary Espy has looked at the agency, and we are at a junction when we are reorganizing Farmers Home Administration. It is a prime time for us to establish what we are talking about here today, and that is centralized servicing.

We are still crossing Ts and dotting the Is. But we will have an opportunity for outreach, circuit riders, service when needed, assistance in preparing applications, technical and financial advice, and supervisory visits to delinquent borrowers. Processing and servicing centers, which could be centralized within the States, would handle loan making, appraisals, and service activities such as supervisory calls, letters, workout plans and management reviews, among other duties.

Supervisory service calls and letters would include automatic dialing to delinquent borrowers, monthly billing statements, the collection of funds to pay taxes and insurance as part of the regular monthly payment, amortized payment schedules, late fees, and automatic generation of servicing letters to borrowers.

State offices would provide policy and management guidance and professional services by architects and engineers presently housed in our State offices. There are distinct advantages to having centralized or consolidated servicing performed in the reorganized agency.

These advantages include continued supervised credit and technical assistance, fewer offices with duties restructured for more specialized service provided, fewer personnel for better service as envisioned under Secretary Espy's reorganization plan, more consistent servicing across the Nation, staff at the local level for outreach inspection or any other duties needed for personal contact, and a separation of the farm loans from the housing loans.

Mr. Chairman, you have talked a bit about what has happened here in the past with proposals that the agency has gone through, and IDC did a study on what the cost would be for centralized servicing from the agency versus other companies.

The recommendation is that it should cost approximately $129 per loan. What we currently have from the one instance when we did sell off some loans, is a cost of $280 per loan. The estimate for Farmers Home Administration cost for servicing those were $240 per loan.

Mr. Chairman, I think we need to work together to find out why we can't get to that $129 per loan cost for servicing of these accounts.

Mr. CONDIT. Thank you very much.

[The prepared statement of Mr. Dunn follows:]

MICHAEL V. DUNN, ADMINISTRATOR

FARMERS HOME ADMINISTRATION

UNITED STATES DEPARTMENT OF AGRICULTURE

Before the

SUBCOMMITTEE ON INFORMATION, JUSTICE,

TRANSPORTATION, AND AGRICULTURE

HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

February 9, 1994

Good morning, Mr. Chairman. Thank you for this opportunity to discuss loan servicing as it relates to the single-family housing loan portfolio of the Farmers Home Administration.

This is a matter of considerable interest to us because it addresses two important issues: First, providing supervised credit to those rural Americans of truly modest means; second, meeting mandates created by the budget deficit to continue to reduce the costs of government.

Returning the Farmers Home Administration (FmHA) to its traditional mission of supervised credit is a key goal of this Administration. A look at the rural housing program and the people it serves shows why this is necessary.

Supervised Credit

FmHA borrowers typically are people with low and very low incomes. Low income is defined as 80 percent of the median family income for the area. Very low income is 50 percent of the median family income for the area. The national median income in rural areas is $27,254.

The average adjusted income for FmHA's single-family borrowers is $16,700. In some low cost areas, a person could qualify for a home ownership loan with a household income below $8,450 a year.

In addition to having very limited incomes, these borrowers typically have little savings and no down payment, and they are currently renting a place to live, often in substandard housing. Unlike most conventional loan programs, people eligible for an FmHA loan may qualify for home ownership with no down payment.

In spite of what may appear to be an unpromising financial position for a long-term loan on the part of these borrowers, experience has shown that they are good risks when they are given the necessary counseling and other assistance.

This is the essence of supervised credit. It involves in depth interviews with applicants on eligibility requirements; technical assistance, on-site selection, and home construction; financial counseling on the feasibility of the type of home construction to meet their needs; in-depth financial analysis and counseling on household finances, including mortgage payment requirements; and referral to other possible sources of financing if FmHA is unable to make a loan.

Supervised credit includes a continued relationship with the borrower after the loan is made to see that payments are made promptly and problems that may interfere with prompt and regular payments are addressed in a timely manner. For instance, if a plant closes in a small community, FmHA can grant loan moratoriums for borrowers employed at that plant. In such cases, a community typically works vigorously to find a replacement operation, and borrowers then become able to resume loan payments.

As a matter of interest, Mr. Chairman, the single-family housing loan program under discussion today has been selected for a pilot under the Government Performance and Results Act.

A task force of representatives from the Department of Agriculture and the General Accounting Office has recommended consideration of performance by:

- Input measures such as employee expertise, loan making and servicing costs, and credit reform subsidy rates;
- Process measures such as customer outreach and education, time to process loan applications, and time to process appeals;
- Output measures such as the number of loans made, funds obligated, loans by race, income, and gender, and housing inventory; and
- Outcome measures such as success at home ownership, loan delinquencies, graduations to other credit, inventory houses leased for use by the homeless, and loan write offs, among others.

Loan Servicing

FmHA has been examining its loan servicing for some time, especially in view of various audits and reports such as the one just presented to you. We have wondered if having each of some 680,000 loans serviced in individual county offices is the most efficient way to do it.

Our studies, both external and internal, indicate that some form of centralized or consolidated servicing would provide cost savings. Fewer, but more specialized, personnel would be needed. Underwriting and servicing could be separated to conform to

requirements of the Office of Management and Budget (OMB) and to reduce the possibility of waste, fraud, and abuse.

The question then arises: who should preform the centralized servicing -- and how should it be done?

A benefit of keeping the servicing in the Agency, of consolidating rather than centralizing, is that it would permit the continuation of supervised credit and the individual attention, as needed, by the borrower from the Agency in order to become a successful home owner. The Administration, however, is still examining the issue of how to provide the best servicing and will soon be able to recommend a course of action.

New Accounting and Escrow System

Mr. Chairman, you are aware that the Department of Agriculture, along with other executive departments, is undergoing a major reorganization. This provides us both an opportunity and the means to bring the servicing of this portfolio up-to-date. This reorganization coincides with the adoption of a new accounting and escrow system for single-family home loan borrowers.

FmHA is required by law to establish an escrowing service for its borrowers. We are planning to purchase a new single-

family accounting system. It would allow the escrowing of taxes and insurance, amortized payment schedules, monthly billing statements, and automated servicing.

The cost of maintaining the current accounting system, which also includes farm loans, is $20 million a year. We do not have a breakdown yet of the savings when rural housing loans are separated, but we expect them to be substantial.

Currently, we are advancing another $20 million a year vouchering for taxes on behalf of borrowers. These advances are amortizing the existing single-family loan. In effect, FmHA is escrowing in reverse. This practice will be eliminated entirely when the escrow system is in place.

We have adopted an implementation schedule for the escrow and accounting system, with a target date of October 1996 to begin operations. The schedule to begin the acquisition cycle is March, 1995; to award contracts, August, 1995; to begin acceptance testing, April, 1996; and to begin escrowing, October, 1996.

Additional Systems Development

The development of the escrowing and amortization system for the single-family housing loan portfolio is only one aspect of

the modernization efforts that FmHA must undertake. It is no secret that FmHA's systems are outdated, inefficient, extremely expensive to maintain and, frankly do not meet the needs of either the Agency or the public we serve.

Deficiencies in the systems have been noted by the Office of Inspector General, the General Accounting Office, and even our own internal reviews. Deficiencies in our accounting systems, especially our Guaranteed Loan Accounting System, are included in OMB's High Risk report.

There is a backlog of hundreds of formal requests for automation improvements submitted by our own staff. We estimate that the cost of maintaining this deficient system during Fiscal Year 1994 will be $20 million.

We can no longer afford to continue down this same path. Better training of personnel, revised regulations, and additional servicing legislation can only go so far. We cannot make dramatic improvements in our supervised credit efforts without also making dramatic improvements to our automated processes and financial accounting systems.

We must develop a comprehensive strategy for addressing our automation needs, and we must start as soon as possible. But we must have a means of financing this enormous undertaking.

We will be seeking to identify additional sources of revenue. For example, H.R. 3400, as passed by the House, includes a provision that would allow for retaining a percentage of the cash collections, so long as the agency in question meets the performance standards developed by this Administration. Something like this could provide a means of funding needed improvements. Our aim is to provide the resources, both contract support and staff support, for the development of an automated system that truly support the mission of this Agency. We would greatly appreciate the opportunity to work with this Subcommittee to explore methods of improving our service in this area.

New Office Structure

Although we are still crossing some T's and dotting some I's on reorganization, we can envision a structure under which local offices would provide: outreach; "circuit rider" service when needed; assistance in preparing applications; technical and financial advice; and supervisory visits to delinquent borrowers.

Processing and servicing centers, which could be centralized within the states, would handle loan making, appraisals and servicing activities such as supervisory calls, letters, workout plans and management reviews, among other duties.

Supervisory servicing calls and letters would include:

automatic dialing to delinquent borrowers; monthly billing statements; collection of funds to pay taxes and insurance as part of the regular monthly statement; amortized payment schedules; late fees; and automatic generation of servicing letters to borrowers.

State offices would provide policy and management guidance and professional services by architects and engineers.

There are distinct advantages in having centralized or consolidated servicing performed in the reorganized agency.

These advantages are:

- Continued supervised credit and technical assistance.
- Fewer offices, with duties restructured and more specialized services provided.
- Fewer personnel and better service, as envisioned under Secretary Espy's reorganization plan.
- More consistent servicing across the nation.
- Staff at the local level for outreach, inspections and any other duties needing personal contact.
- A separation of the farm loans from the housing.

In conclusion, with the overall reorganization, the new accounting and escrow system, and the size of the loan portfolio, caution is dictated. Our active portfolio of about 680,000 loans

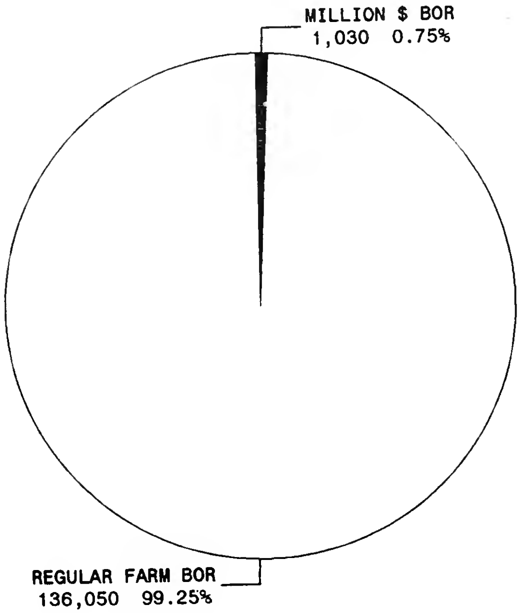
with a value of $18.5 billion, places us among the top five mortgage lenders in the nation. We are proceeding carefully.

I would be happy to take any questions you might have. Thank you.

SMALL FARM vs LARGE FARM BORROWERS

AS OF: 12/31/93

FmHA FARMER PROGRAMS CASELOAD



SOURCE: FINANCE OFFICE FOCUS DATA *RC540* DATA BASE

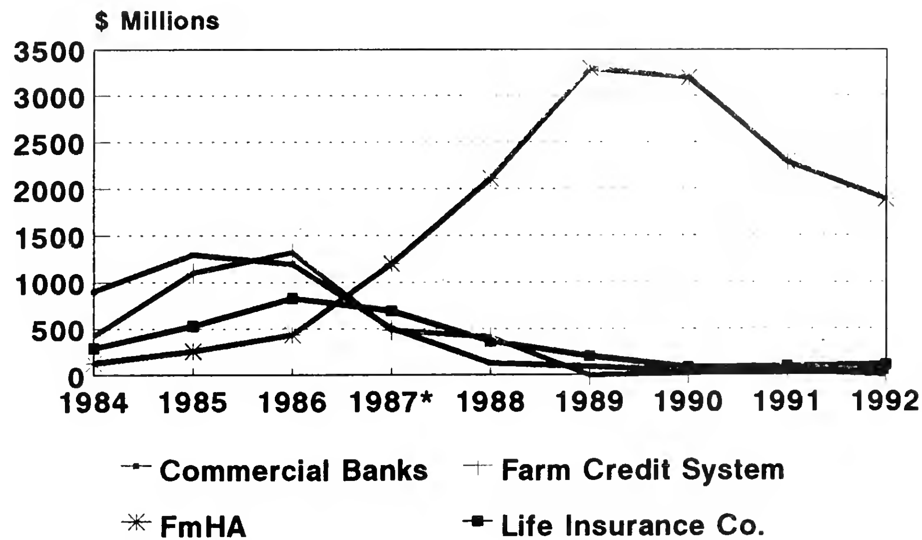
TOTAL DELINQUENT P & I DOLLARS

AS OF: 12/31/93
(DOLLARS 1,000,000)

DELINQUENCY BREAKDOWN

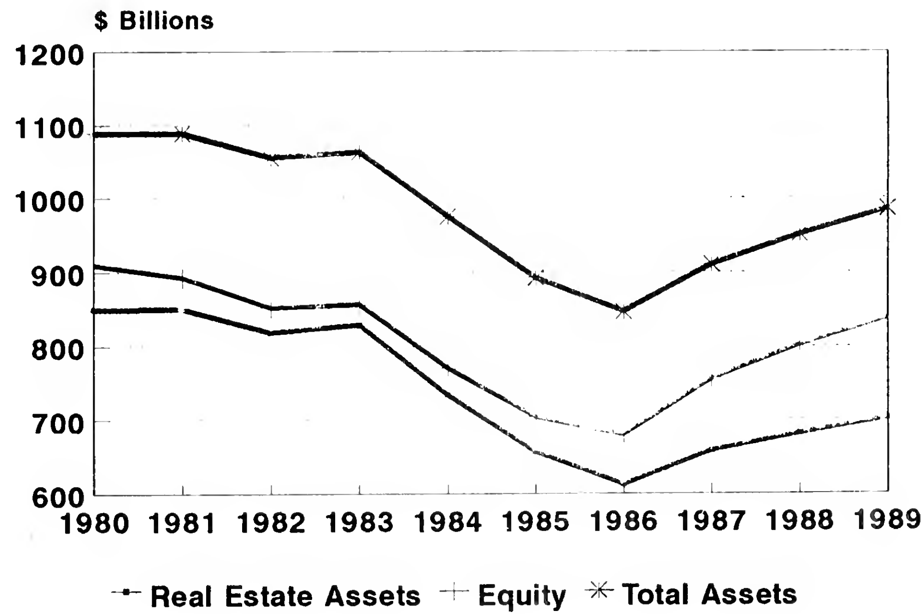
SOURCE: FINANCE OFFICE FOCUS DATA *RC540* DATA BASE

FARM LOAN LOSSES
BY LENDER



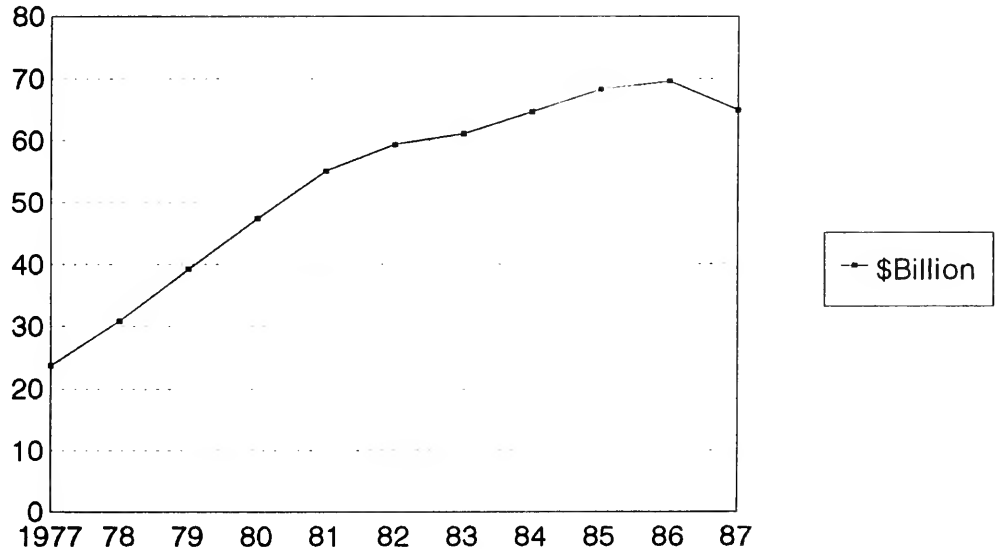
* starting in the fourth quarter of 1987 commercial lenders could spread agricultural losses over seven years.

U.S. FARMING
ECONOMIC DECLINE



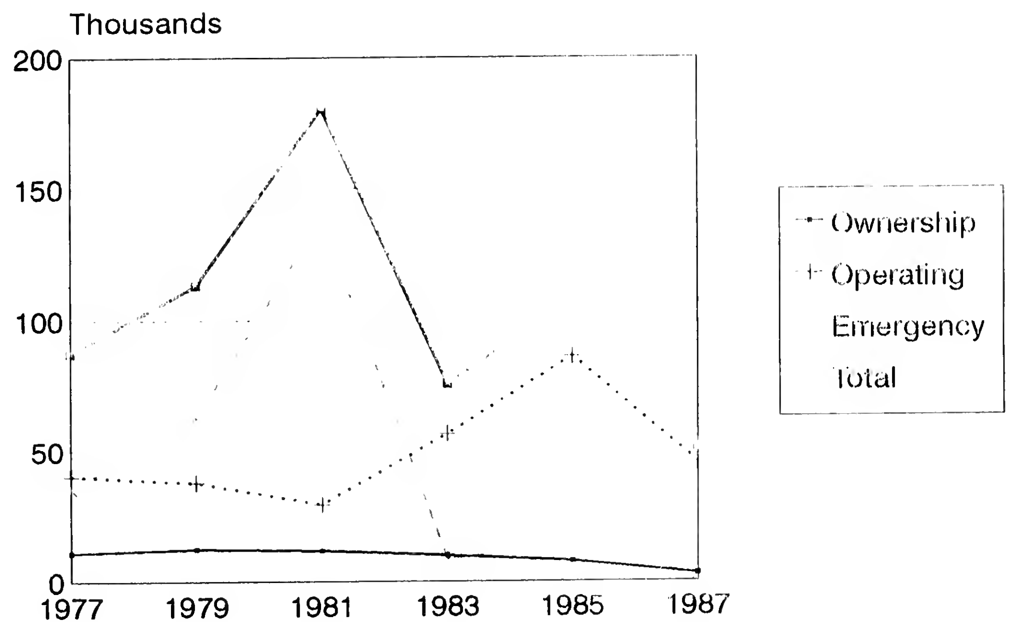
Growth in FmHA's Loan Portfolio

All Loan Programs



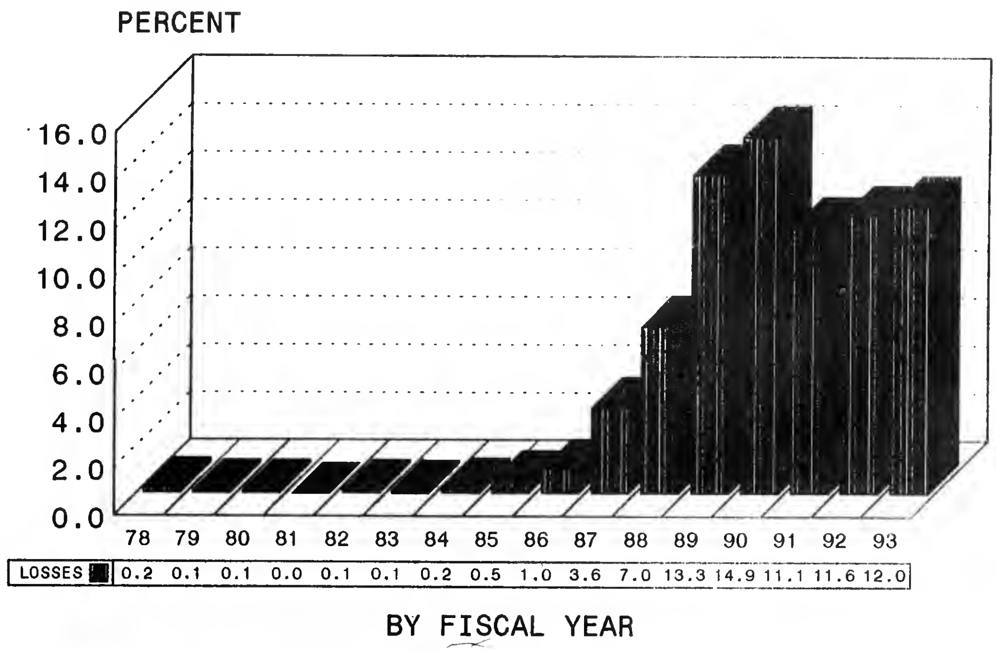
(From $23.7 billion to $64.9 billion)

FmHA Farm Loans, 1977-1987



PERCENTAGE COMPARISON OF LOSSES PAID TO PRINCIPAL OUTSTANDING

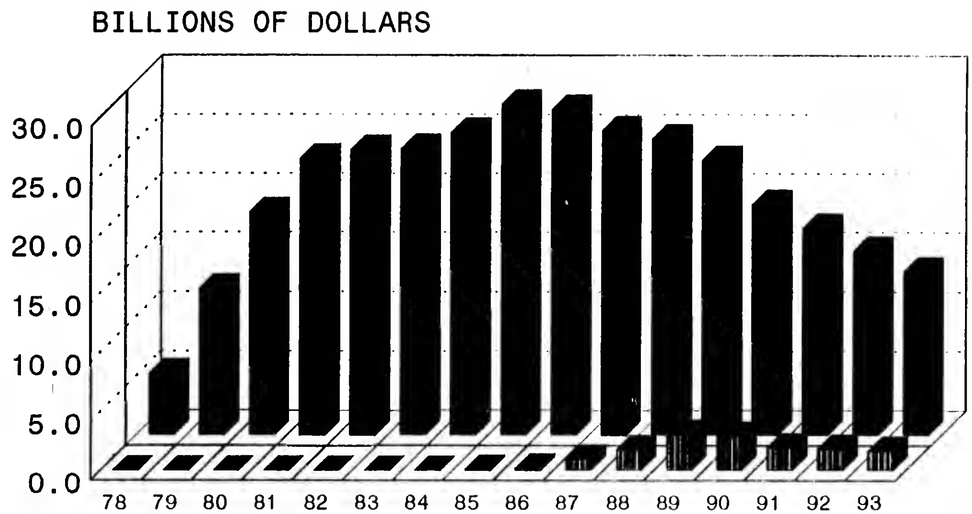
AS OF: 12/31/93



SOURCE: FINANCE OFFICE REPORTS 523 AND 616

COMPARISON OF LOSSES PAID TO PRINCIPAL OUTSTANDING

AS OF: 12/31/93



	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93
PRINCIPAL	5.2	12.3	18.8	23.4	24.1	24.2	25.6	28.0	27.6	25.8	25.1	23.3	19.5	17.5	15.5	13.8
LOSSES	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.3	0.9	1.8	3.1	2.9	1.9	1.8	1.7

BY FISCAL YEAR

SOURCE: FINANCE OFFICE REPORTS 523 AND 616

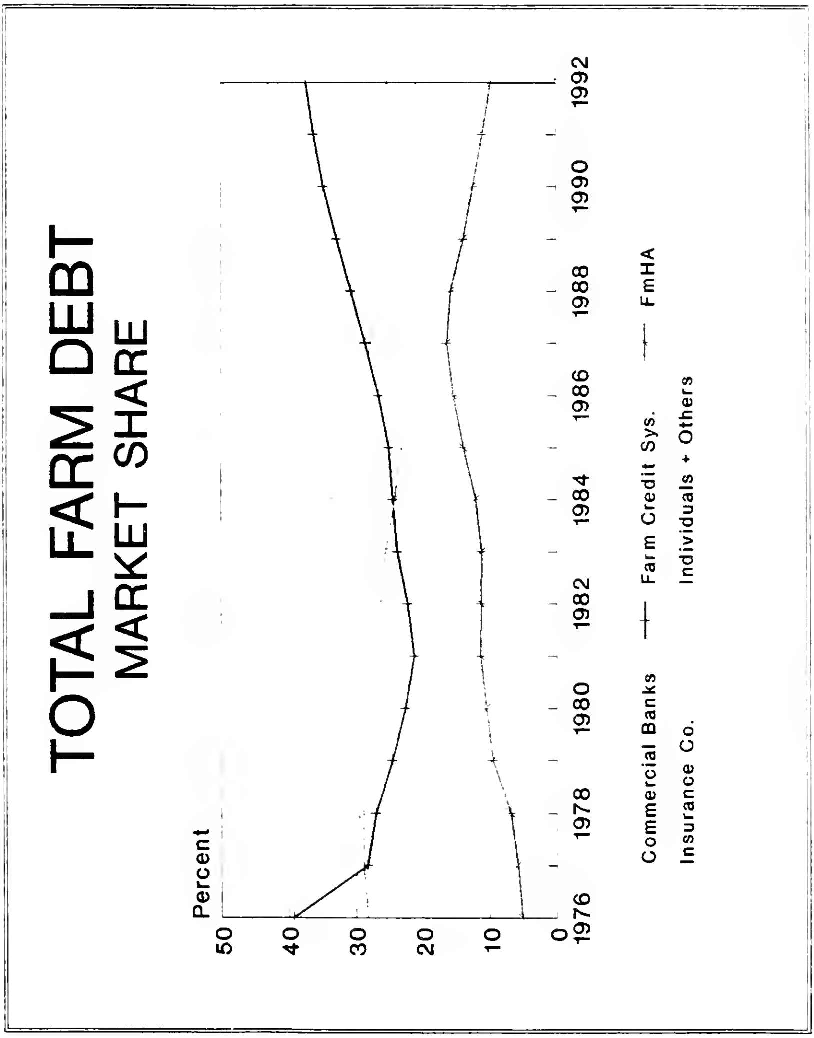
FARMER PROGRAMS P & I DOLLARS OUTSTANDING

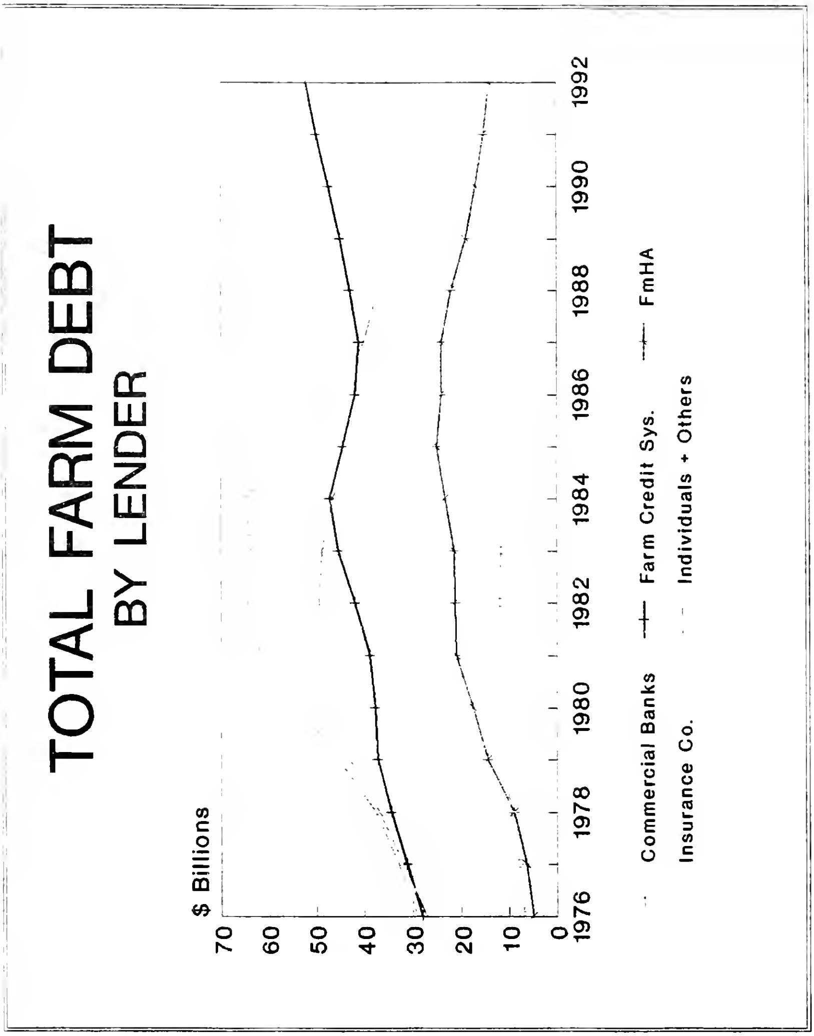
AS OF: 12/31/93
(DOLLARS 1,000,000)

REGULAR FARM BORROWERS

MILLION $ BORROWERS

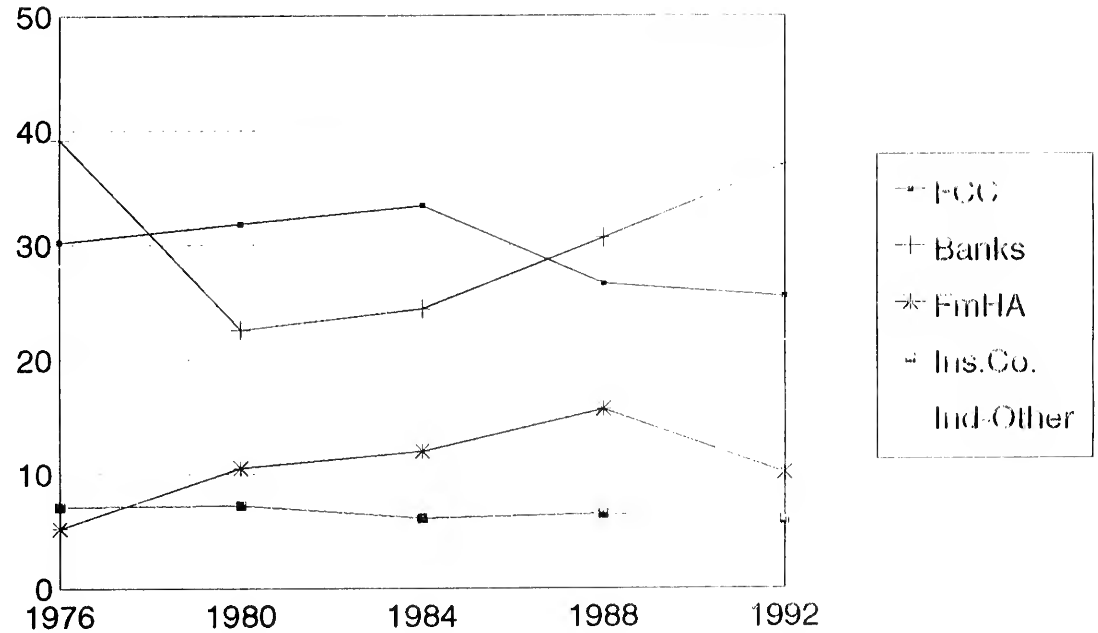
SOURCE: FINANCE OFFICE FOCUS DATA *RC540* DATA BASE


TOTAL FARM DEBT
MARKET SHARE
Percent
50
40
30
20
10
0
1976
1978
1980
1982
1984
1986
1988
1990
1992
Commercial Banks
Farm Credit Sys.
FmHA
Insurance Co.
Individuals + Others


TOTAL FARM DEBT
BY LENDER
$ Billions
70
60
50
40
30
20
10
0
1976
1978
1980
1982
1984
1986
1988
1990
1992
Commercial Banks
Farm Credit Sys.
FmHA
Insurance Co.
Individuals + Others

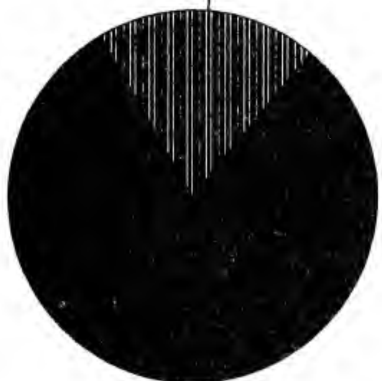
Farm Debt Distribution

By Percentage

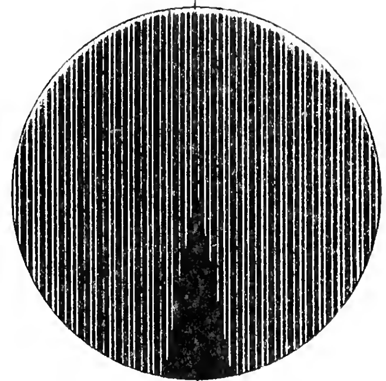


MAKE UP OF FmHA FARMER PROGRAMS BORROWERS

AS OF: 12/31/93



REGULAR FARM BORROWERS



MILLION $ BORROWERS

SOURCE: FINANCE OFFICE FOCUS DATA *RC540* DATA BASE

Mr. CONDIT. The committee will look at H.R. 3400, see what jurisdictional areas we have in common with that, and get back to you and see if we can do something in that area. I appreciate you bringing that up.

It appears and it has been written that the agency is making many loans to borrowers who are already delinquent. Can you tell us what you are doing with these people to make sure that the Farmers Home is not compounding their problem?

Mr. DUNN. Mr. Chairman, let me make the distinction here, that that is in the farm loan area, not in housing area.

Mr. CONDIT. Sure. I should have done that in the question.

Mr. DUNN. That was a policy of continuation with the borrowers. The genesis of that was from the Appropriations Committee requesting—mandating—that the agency provide those continuation loans, i.e., annual operating loans to individuals so that families would have living expenses.

It is felt that it is not the government's policy to starve people off the land. That was the policy behind those continuation loans.

Mr. CONDIT. Do you agree with the decision made by the Appropriations Committee?

Mr. DUNN. Mr. Chairman, I think we should act with compassion. The U.S. Government should have compassion, but we should also be professional in what we are doing. It should not take a hiatus of 7 or 8 years to get to the point where we restructure a loan to make it work.

That exacerbated the problems that we have and it compounded these new loans. Interest on these new loans ballooned the number and amount of delinquents that we had.

I believe, Mr. Chairman, what we ought to do is get back to supervised credit, get out in front of these loans, and provide the servicing activities and tools that we need for our loan officers to work with our borrowers to keep these loans from going delinquent in the first place. That will be the thrust of this administration.

Mr. CONDIT. Is it true that the Secretary will soon be lifting his farm foreclosure moratorium, and if so, do you have any idea what the timetable might be?

Mr. DUNN. Mr. Chairman, the suspension of foreclosures should be announced today.

Mr. CONDIT. It has been mentioned about the Post article that ran some stories in the past 2 weeks detailing borrowers who seem to have adequate assets to settle their debts or at least resume payments. What is being done about this issue?

Mr. DUNN. Mr. Chairman, that issue is one that we should all be concerned about. We have had approximately 1,400 large loans, and over $1 million that were made over a decade ago. Congress in its wisdom has shut the door on those type of loans. They can no longer be made to those types of individuals. But we still have those on the books.

Those large loans in the farm area represent less than 1 percent of the total loan portfolio—75 percent yet it makes up almost 40 percent of the delinquency dollars that we have.

This administration finds that unconscionable, Mr. Chairman. We are doing everything humanly and legally possible to recapture every dime that we can for the U.S. Government.

We have established a large loan group at the national level. We have provided training at the local level. We have set up each of these States to have a large loan workout plan of action. We have conducted training with those people.

We have gone out and contracted with asset investigation companies, 20 of them across the Nation, to investigate whether or not there are assets that have been converted from these large loans to ensure that we get every penny that is owed the U.S. Government that we can possibly recapture.

I would hope, Mr. Chairman, within the next 12 to 24 months, we can give you a much brighter picture on our performance in that area.

Mr. CONDIT. Tell me, just to satisfy my curiosity, when we lend the money to the people who apparently have assets, or the ability to resume payments, do we attach assets or do they give us those assets in some signature form?

Mr. DUNN. At the present time, Mr. Chairman, our policy is to get as collateral every single asset the individual has. That has precluded us from making some loans lately.

What happened when these loans were made was that the collateral was based upon the asset value primarily of the property. Then we had a 60 percent devaluation of assets during the crash of the agricultural sector in the 1980's.

Therefore, those assets that we lent money on were no longer there. And that is why we are ending up with loans in a greater amount than what that asset value is.

Mr. CONDIT. So you are telling me the assets or the assets on the property that they made the loan are gone?

Mr. DUNN. That is correct.

Mr. CONDIT. How about unrelated properties?

Mr. DUNN. At the present time, it is the policy of the agency to try to get every asset the individual has as collateral.

Mr. CONDIT. But do you do that? Is it just a policy or do you absolutely adhere to that and if you do that, and if you do that, have you collected?

Mr. DUNN. That is what we currently require before we make a loan. Now, Mr. Chairman, that is not retroactive. We have to go back to when those loans were made and when those notes were signed.

Mr. CONDIT. You say it is a current policy, it has not been a past policy?

Mr. DUNN. That is correct.

Mr. CONDIT. When did it start?

Mr. DUNN. Mr. Chairman, I am told that was in the mid-1980s, that the policy began.

Mr. CONDIT. All right. Well, it has just been pointed out, maybe you can respond to this on the GAO report we did 2 years ago, which states that you don't do what we just talked about, and obviously I am paraphrasing, but you don't do that.

Are you aware of this GAO report on page 2?

Mr. DUNN. Is that on a housing loan or the farm loans?

Mr. CONDIT. Farmers Home loans.

Mr. DUNN. Mr. Chairman, I know that is the current policy. I can't tell you when it was implemented. I will respond to the committee.

[The information follows:]

The applicant/borrower is required to pledge all collateral as security to FmHA in consideration of a loan, by signing the necessary forms.

The agency perfects its lien on chattels by having the borrower execute a Financing Statement and a Security Agreement, which describes the collateral pledged as security for the loan(s). The Financing Statement is filed for record with the Secretary of State or other appropriate office.

The Agency perfects a lien on real estate by filing a Deed of Trust/Real Estate Mortgage for record at the Registry of Deeds Office. This filing occurs after the voluntary execution of said Deed/Mortgage by the borrower(s).

With respect to the emergency (EM) loan program, the "lien on all assets" policy was implemented by an unnumbered letter dated May 31, 1985. The EM loan regulations were not revised to reflect this policy until April 30, 1992.

Before May 31, 1991, with respect to unrelated assets (nonessential assets), the borrower, as a condition of loan approval, had to agree to sell such assets. The proceeds from the sale were used to reduce the size of the EM loan if sold prior to loan closing. If the nonessential assets were not sold prior to closing, the borrower mortgaged the assets to FmHA with an agreement that such assets would be sold within one year of loan closing. Problems were encountered with respect to this requirement. Therefore, on Mary 31, 1991, the policy was revised, requiring the applicant to pledge the nonessential assets for security for the proposed loan. This security as in addition to the regular required security.

The "lien on all assets" policy was implemented for all farmer program loans on April 30, 1992. A proposed rule was published in the Federal Register on January 14, 1994, to modify collateral requirements for direct farmer program loans.

Mr. CONDIT. I will just move to a couple of housing questions. What do you expect to spend on creating your section 502 service center?

Mr. DUNN. Could you repeat the——

Mr. CONDIT. What do you expect to spend on creating your section 502 servicing or service center?

Mr. DUNN. On the escrow accounting system?

Mr. CONDIT. The centralizing service center.

Mr. DUNN. Mr. Chairman, we do not have an absolute price on that at this particular time. We are in the beginning stages. As I said 2 months ago when I took over as the Administrator, I designated this as one of the areas that we were going to go forward on.

We have put together a preliminary task force. We have outlined our plan of action. What we are going to do is purchase a commercial program that we will then modify to allow us to do the type of supervision and working with our types of employees.

That dollar amount of what that is going to cost has yet to be determined.

Mr. CONDIT. You are doing a study to do that, or have you decided to do it?

Mr. DUNN. Mr. Chairman, as I reviewed the agency, I think they have had too many studies already and spent too much money on studies. I have asked existing employees and a task force to put this together.

Mr. CONDIT. Is there any cost attached to this proposal?

Mr. DUNN. We do not at this time have the private sector contract cost available, so I cannot give you how much. We estimate that it could cost $4 million.

Mr. CONDIT. Can you do that at a later date for us?

Mr. DUNN. Yes, Mr. Chairman.

[The information follows:]

A preliminary estimate for the cost of the software, adapting it for FmHA's purposes and making it fully operational for servicing 680,000 loans is approximately $10 million.

Mr. CONDIT. The National Performance Review draft break-out report on HUD states that loan servicing is not an appropriate task to be performed by government agencies and should be contracted out.

I take it, and please tell me in clear, concise terms if you disagree with that. I take it you don't agree with that.

Mr. DUNN. Mr. Chairman, I do not agree with that, given the strata of income level that we are mandated to assist in rural communities. We are working with low income people, the poorest of the poor, and helping to provide housing for them.

It vastly differs from other mortgage institutions, because of the strata of folks that we are supposed to be working with, and the mandate that we provide them with supervised credit.

In other words, what we envision our function is to sit down with potential homeowners, help them work out their budget, show them you how they can pay for that home, give them training on homeownership, make periodic visits to those individuals, know their situation, so that if a person is laid off, if there is a flood like we had in many parts of the Nation, our supervisors get out front

and go in and work with those people prior to their loans getting delinquent.

One of our primary goals is to get out in front, to cut down on the number of new loan delinquencies.

Mr. CONDIT. You think that HUD doesn't deal with the same strata that you do, in terms of the income of people you deal with?

Mr. DUNN. No, Mr. Chairman, they do not have the type of homeowner loan program that we have.

Mr. CONDIT. How about income levels? Aren't the income levels pretty close to the same, or am I wrong?

VOICE. We have a different program for homeownership than HUD. HUD has no subsidized homeownership program for new borrowers coming into the program. Our direct program is a subsidy program where we make loans to those of 80 percent of median or less.

In fact, Congress has mandated that 40 percent of those moneys this year, $1.8 billion, be made to families of 50 percent median or less, and all of those families qualify for subsidy. And this is a completely different strata of loans.

We have a guaranteed housing program which is from 80 percent to 115 percent of median, and then we begin to move into the same strata of program that HUD has.

Mr. CONDIT. Those of us who come from rural agricultural areas are greatly concerned about the decision to cut field offices. We are going to be watch that very carefully.

Frankly, we support some of that being done. We think it has to be done, but we also understand there may be an impact on some of us in rural areas. But does the decision to centralize in-house fly in the face of the Secretary's intention to reduce field headquarters and staff equally?

Here you are going to go to this centralized place and you are going to cut the field offices. For some of us, it is sort of like, you cut the field offices, some of them may be necessary and some not, but you are going to enhance centralized services which may be inside the Beltway somewhere.

Mr. DUNN. As the previous witness testified, most indications are that going to centralized servicing within a State we would be able to save on personnel because we would be able to do more of that servicing. We will be able to close down some of those offices that aren't needed because they are doing a large amount of those routine servicing things.

We spend an inordinate amount of time in collecting data right now before we can do routine servicing. If we have a central place to get that data, if we can have the loans flagged the day they go delinquent instead of having to go through the lock box process and discovering the delinquency later on, we are way ahead of the game, we can get in front.

We do intend to be colocated in the farm service agency offices so that we have a USDA service center. And we also intend, Mr. Chairman, to provide the automated data information system that will allow us to exchange information more readily and to get us into the 20th century, to be able to provide better services with fewer folks.

Mr. CONDIT. Let me ask you, you are going to centralize services, which means you are going to group field offices together somewhere in the States, California, you are going to lump two or three together. Is that what we are talking about?

Mr. DUNN. We would have to look at the individual States, with California being a larger State, but primarily what we envision right now is the majority of the servicing coming at the State level.

Mr. CONDIT. Well, OK. And your hopes would be to cut overhead cost, personnel, office space, et cetera?

Mr. DUNN. That is correct.

Mr. CONDIT. Do you have equal reduction with staffing down the stream?

Mr. DUNN. There will be a reduction in staffing down the stream. Currently, we have some 1,700 offices. After the restructuring, we probably will end up in the neighborhood of 1,200 offices.

Mr. CONDIT. Do they correspond, reducing field offices into a centralized office, does—the function that they perform, does that correspond with functions here? I am not talking about some other program. I am talking about these programs.

Mr. DUNN. Yes. Mr. Chairman, we will be able to capture the data that the people need to service out in the field at that centralized location and get it to them in a timely manner, that they are now taking time to go through and glean out themselves.

And that is where we are going to have a tremendous savings. That is what the previous witness had been testifying about.

Mr. CONDIT. Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman.

Mr. DUNN. Mr. Chairman, if I can, Congressman, the other part of reduction on that is at the national level.

Mr. CONDIT. That is kind of what I was saying.

Mr. DUNN. I am sorry, I misunderstood the thrust of your question here. If we can get the types of changes in the accounting and automation system that we would like to see out here, I think we can see tremendous savings at that level.

Mr. CONDIT. Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman. First of all, Mr. Dunn, I am looking—I am optimistic, having you in this new position. I think that you will make a valid attempt to try to straighten out some of these things that have been dragging on too long, although I will say that my predecessor, Bob Erglund, who I think you worked with back in those days, came to Congress or came to the Secretary's office and he straightened out the Farmers Home Administration, and it literally ate him alive. So you have a big job ahead of you.

Mr. DUNN. Thank you, Mr. Peterson.

Mr. PETERSON. I just want to see if you agree with—maybe give you a little bit of advice here, for whatever it is worth—I think that what we saw in the paper the other day was some mistakes that we made trying to be compassionate, trying to help people.

And what so often happens is the folks that have the resources, maybe you could say the smartest can go out and hire the best lawyers and the best accountants, are going to take us to the cleaners, and maybe not all of these people, but generally I think that is what happened to us.

And we had a policy, we got into this situation, now there is not much we can do about it, and it looks bad. So maybe what you ought to do is just fess up and say, this was a dumb thing, this was done, and kind of put it behind us and say that you are going to have some kind of policy so this doesn't happen again.

Which brings me to my second point, which is what is happening out there now, which I think to some extent you have overreacted by grabbing all of these assets, you are exactly right, you have literally stopped the activity out there, and frankly, when a constituent of mine comes to me and has some problems and talks to me about how can they get involved with Farmers Home and how can they get some help through the situation, I give them the advice if you are not involved, you should stay away, which is a sad situation.

So because of that fact, you get tangled up in this and you don't have things operating very well out there yet. There are a lot of bureaucratic problems and other kinds of problems. So I don't know how you untangle all of this, but we don't need all this publicity that went on.

It is not your fault, but I don't know how we educate the public about this complicated area. Do you disagree with my assessment of what happened?

Mr. DUNN. Congressman, I totally agree with what you are saying here. The optimal word here is yet, because we are putting things in place. This administration, the Clinton administration, in keeping with the NPR report of reinventing government, we are setting about to rectify some of the problems we have had in the past.

We are going to refocus on that mission of helping those that need our help and providing them all the resources that they need to correct those problems. When we go into one of these farm loans, we need to be able to go out and do an analysis of what that enterprise is, every one of the enterprises, whether they are making money on the hogs or losing it on the cattle.

And we need to be able to sit down with that borrower on a quarterly basis, even, and say, here are your strengths, here are your weaknesses, and here are some ways to capitalize on the strengths, and here are some ways to correct those weaknesses. That is what supervised credit is all about.

We need to be able to work with the commercial banks to get them to take these folks on once we graduate them, once we get them to the point where they can handle credit, and they understand that recordkeeping has to be done, and that marketing has to be done, that input costs have to be meticulously looked at.

That is what the management of the agency is all about, in both housing, the farm side, and Mr. Peterson, that is what we want to get to.

On putting behind us those large loans, I wish we could. I really do. That is 40 percent of our delinquency program. I would like to be able to say we are going to put them behind us. I would like to say let's just write them all off, if that could happen that way, but that is not what my job is. My job is to go out and see what assets are out there.

We need to work through those loans. We need to work with those borrowers as well. Because the 1987 act said we are to do whatever realizes the most money for the Federal Government.

Mr. PETERSON. But if the Secretary puts on moratoriums, these are the kinds of things that gets us into these problems. That is a lot of the problem that has been caused.

Mr. DUNN. Let me talk about the Secretary's suspension. I have to make that technical distinction between a suspension and a moratorium, but we learned a great deal from that.

The Secretary did ask for a very indepth review of what we were doing. And we found out that in 35 percent of the cases, we weren't following our own regulations. So what we were doing is setting ourselves up for an appeal or a court case that would throw out the acceleration that we were doing.

We have gone back to study that. We also looked at what the genesis was of most of these loans that were in delinquency; 40 percent of them were because of some natural disaster that took place.

Mr. Peterson, that told me that I had to do something to provide for these disaster loans that we think we are going to get in your State and the other Mississippi valley States.

And so we have put together a specially trained jump team. We have given them a special computer program to help analyze those emergency loans, so we don't go out there and create future problems for us.

The suspension that the Secretary had was very useful in telling us how it ought to be conducted.

Mr. PETERSON. I think some of the activity that has gone on for this period of time has caused some of the problem. You are put in a position where you can't deal with it on a businesslike basis, and I think we have to be very careful about that, that we don't put people in an unworkable situation so we go through all this again, which if you do it wrong, we will end up doing.

You have a tough job, but I think you are a very capable person, and we look forward to you coming back in a year and having all this sorted out, having a sweetness and light hearing here.

Mr. DUNN. I appreciate the confidence, Mr. Peterson.

Mr. PETERSON. Thank you for letting me be here, Mr. Chairman.

Mr. CONDIT. Mrs. Thurman.

Mrs. THURMAN. Good morning, Mr. Dunn.

I first want to let you know that the people in Florida have been out talking to us. They have done a really good job with the group that we have done there, and we are real pleased with Mr. Shadburn and the work he is doing there. We will just give him a little kicker here because he really has been putting together some information.

But one of the areas that I have been concerned about, even once you get everything up and running and doing everything right, is dealing with maybe the legal part of this. In fact, I had one person come in and tell me how long it has taken them, or they couldn't get any work out of the attorney's office to get these cases running.

Are you looking into that at all?

Mr. DUNN. Yes, we are, Mrs. Thurman. That is one of our primary concerns and one of the recommendations that the Secretary

is making, that we allow OIG to do some investigation, where there may be criminal activities, and also that we use our OGC in our department to be deputized by the Department of Justice and allow them to prosecute these cases to fruition.

Oftentimes we find that the regional attorneys are swamped with immediate problems, crime problems, et cetera, and they just don't have the wherewithal to go after these cases.

And I understand, they are prioritizing them for the best of the reasons. But we feel we have a stake in this as well, and we have asked for deputization of the OGC folks so that we can do that.

Mrs. THURMAN. Good. Let me just ask another question. Do you agree with the studies that indicate that $106 million per year could be saved by implementing centralized servicing?

Mr. DUNN. I think we can probably save something near that figure. When you combine that with the escrowing we are talking about, when you combine with an accounting and information and management system. I think we might even be able to exceed that figure.

Mrs. THURMAN. And then you would have a timetable for actually giving training to the people and doing those things. One of the things that I think bothers me, and I haven't been here and you haven't been here, but just in the reports that we were given or looked at that much of this has been—or goes back historically as far as 1986, now you are saying that we might implement it by 1996, what kind of assurance can you give us that in fact this is going to take place?

Mr. DUNN. I think that the assurance I would give you is our pledge to work with this subcommittee to show you how we are going to do that, to submit to you time lines so that you can check up on us.

As we go through this, one of the reasons why I am excited about us going through the Government Performance and Results Act is that inherent in that act is the mandate we have to have measurable results at a time-certain. That is the type of thing we hope to provide for you, and you can hold our feet to the fire.

It is unconscionable, in my opinion, that moneys have been spent in the past for studies, and they have starts and stops to try to do these things—like the escrow system—and it fell on its face because they tried to use the existing accounting system that we have.

I don't think that can be used. I am saying it is time to get rid of that, it is time for us to put together a strategic plan at Farmers Home Administration that will allow you and the rest of the Nation to know exactly where we are going to go, when we are going to do it, how we are going to do it, and what the anticipated outputs are.

Mrs. THURMAN. Then I will ask our chairman to make sure we get that kind of information constantly, because I think it is important that we don't fall behind any more than we already have.

Thank you.

Mr. CONDIT. Mr. Stupak.

Mr. STUPAK. Thank you, Mr. Chairman.

Mr. Dunn, I guess it is maybe more of a comment, and maybe you could respond to it, if you go from 1,700 down to 1,200 offices,

service centers, as you call them, it seems to me that one of the problems you face, or have been faced with in the past is in order to cut delinquencies, in order to establish an escrow account, maybe to reduce foreclosures, there has to be more attention paid to your customers, if you will.

But if you are going to downsize and go from 1,700 to 1,200, these employees moving into these service offices will have more tasks, their focus won't be as directed to this program, and won't the opposite happen, won't delinquencies go up, foreclosures go up, just more problems?

I think we need to focus attention to be on this problem. As we move to the central office, we are going to get more tasks to do and get more diverse in our focus.

Mr. DUNN. That is one of the really magnificent parts of Secretary Espy's reorganization plan. Although we will have folks located in 1,200 offices, there will still be approximately 2,500 offices or service centers out there.

We are going to approach this with a team USDA approach, so that we will be utilizing the entire agency as our eyes and ears. There will be opportunities for folks to come in at those USDA service centers, where ASCS offices are currently located, and access by computer the information that they need.

So what we are looking at here is a better utilization of all of the assets that the Secretary has in USDA, but to specialize in the areas that we need to be located in.

Many of those offices that were in the 1,700 right now have various working loads. Some of them may be doing 90 percent housing and only 10 percent farm, or they may be doing the reverse. They may be only doing 10 percent housing and 90 percent farming. Where we will not have the housing presence in those offices that have that type of a caseload, where it is primarily agricultural credit that will be for the new Farm Service Administration.

So what we are doing here is targeting our resources for where our loans are made.

Mr. STUPAK. You may be targeting your resources, but in the last plan, and thank God he is no longer here, but Secretary Madigan had, when he announced his plan 2 days after I took office, he was taking 13 of those offices out of my congressional district, a huge rural district in Michigan.

If you close the offices, in parts of my district people would have to travel 2 to 2½ hours just to reach the office, they are not going to come in and see you for 2½ hours. One way is 2½ hours, 15 minutes, 30 minutes for the interview, then turn around and go back.

Again, how do you keep the focus on the critical needs of this program?

Mr. DUNN. Secretary Espy is writing his own plan, Mr. Stupak, so——

Mr. STUPAK. I am much more impressed with his plan, believe me.

Mr. DUNN. There will be a difference, and I can't tell you what the impact will be in any congressional district at this point because those decisions simply have not been made.

But we do intend to use circuit riders. We do intend to get our people out in the countryside where the people are. We can hold office days. We can have mobile offices. This is the 20th century. We don't have computers with modems and faxes on it, but we are going to have that.

We are going to get our people out in the area to service where the need is.

I can't tell you exactly where they are going to be, but I can pledge to you that if you have constituents that have a need for a Farmers Home service for a home loan, they will have someone available to work with them.

Mr. STUPAK. Again, as I said, I started off as more of a comment, I didn't mean to ask you what offices are going to be closed. That is not my purpose.

My purpose is, the problems we have seen in the system is there has been no focus, and that is why delinquencies go up, foreclosures going up, no escrow being established. If you downsize it, it will be less focused, so when these downsizing decisions are made, I hope they are made so those areas where travel is extensive in other areas, you can keep the focus. To be successful, you have to keep the focus.

Downsizing is the opposite of focus. You are going to diverse your views even more. That is my only fear and caution I guess I would give to you on this.

Thanks.

Mr. CONDIT. Mr. Peterson.

Mr. PETERSON. Can I just ask one more? On this computer program or whatever you are buying here to do this, does it have a name?

Mr. DUNN. There are a number of different activities——

Mr. PETERSON. You haven't decided on one program yet?

Mr. DUNN. We have a group called Infoshare which is working to ensure that every agency of USDA can access information from the other agency.

One of the real problems that has been shown time and time again is that we can't talk to each other. We may be next door, but we can't use the same computer runs.

Mr. PETERSON. What is Infoshare?

Mr. DUNN. Infoshare is a program that the Assistant Secretary heads up, which is focusing on providing a platform and a network system that will allow to us do that. So instead of us working individually on it, we have all of our folks at ASCS, Farmers Home, Rural Development Administration, SES jointly saying these are the new systems we are going to have in the future.

Mr. PETERSON. But who is advising you? Who are the technical people?

Mr. DUNN. They are our folks inside the agency.

Mr. PETERSON. That makes me nervous. These are the people that screwed it up in the first place.

Mr. DUNN. I don't know if this is going to alleviate your nervousness or not, Mr. Congressman——

Mr. PETERSON. I have seen what HIS has done at this point.

Mr. DUNN. They have a working group in there and they have an executive board of directors that make all the final decisions

that is made up of the administrators of those agencies, one of which is me.

Mr. PETERSON. I don't want to get too far into it, but is this going to be a PC-based system, then?

Mr. DUNN. That is the direction we are looking at, something that is compatible with the state-of-the-art today.

Mr. PETERSON. This commercial program you are talking about, is that going to run on PCs, or is it going to run on like an AS400 that you can tie PCs into, or do you know? Maybe that is just too technical, but I would like to know what you are up to in more detail.

Mr. DUNN. We will be going to some type of mainframe on this, but that——

Mr. PETERSON. That makes me nervous, too. That is one of the problems. Do you know how many mainframes HUD has? You ought to go over and look at that if you want to see how not to do this. They have seven huge computers that can't talk to each other. Now, they are creating another level without dealing with the first seven.

So, you know, I would like it if you could make available to me, just kind of what commercial program you are looking at, what it is going to run on, and how these PCs are going to interface with it. I would be interested.

Mr. CONDIT. Can you follow up, Mr. Dunn with Mr. Peterson?

Mr. DUNN. We can do that. We can provide you with the direction we are going in and our thought process on that. But it is something that is going to be the state-of-the-art, and it will be in real time so that we can get information that we need out.

Mr. PETERSON. State of the art is now a $1,500 computer. You can run on a $1,500 computer—you can run what 20 years ago the biggest computer in the country would run. I have seen government deals like this where they get sucked into some system they don't need, and you are locked into that architecture and you can't do what you need to do. We do it right here in the House.

You can't buy a computer without paying 3 times more than you need to. You can't get the most current software, they are two generations out of date. And this is a little operation compared to what is going on in the rest of the government.

So I would just hope you would bring people in that will be practical and say, look, we can just go buy this stuff off the shelf at the Radio Shack, we can buy a program that will do these escrows for $500, we don't need to spend hundreds of thousands of dollars.

Mr. DUNN. We agree with you, Mr. Peterson, and it is under the purview of this committee, perhaps a future hearing.

Mr. CONDIT. We are already working on it. It is our understanding that USDA has at least 17 different $25 million systems. But we are in the process of evaluating right now, we will be doing a report on it.

So the issue you bring up is something we are looking at. But if you can provide additional information, we would appreciate that.

[The information follows:]

The Infoshare project is still at the strategic plan stage although work will begin soon on an implementation plan. Attached for the Subcommittee's information is a copy of the Infoshare strategic plan for use as the Subcommittee sees fit.

Mr. CONDIT. Mrs. Thurman, did you have a followup?

Mrs. THURMAN. As the chairman just talked about, when we first got one of our GAO reports and it was on the information services within the Department of Agriculture, one of the things that evidently was passed before we were here, but obviously has not been implemented, do you know whether or not they have hired what they call, quote, "the information officers or officer" that is supposed to be the person in charge of putting all these systems together?

Mr. DUNN. Yes, there is an elaborate hierarchy structure, and an Infoshare team has been put together. Each agency was their own team.

As far as my own observation, I find it incredible that with all the money that has been spent, we still can't do simple things like have LAN systems for everybody in the agency to connect up with here in Washington, let alone nationwide. I can't even do a mail merge. If I am going to send a letter to the Members of Congress, I have to type each one of your names on there. This is pretty simple stuff. We have spent millions.

I don't know what all we got, but its not what I would like to have.

We do have some pilot programs that we are doing in the State of Kentucky. For instance, we have got a system down there in which we are trying to ensure that that entire State is on a backbone system that will allow them to interface with each other.

We are putting together some things. What appears to have happened, as I look at it, is we have hired all of these information people over there, then we have all the program people over here, and they don't seem to talk to each other. The program people don't tell the information people, "this is what we need in a system," and the information people say, oh, look at this, this is the state-of-the-art, I want to buy it, without relating it to what the system needs are.

That is what we are about in the Infoshare. That is what we are about in the agency now, getting those people together to talk so that we don't start running real fast down the wrong road, which the agency has done time and time again in the past.

Mrs. THURMAN. So you are saying that is going on now?

Mr. DUNN. That is correct.

Mrs. THURMAN. Let me ask one other followup question on that because I think the chairman mentioned how much money has already been spent, and I think that quite honestly that makes it difficult for us when we are talking about these things on how much money are they trying to use—I mean, one of the things we saw in here was this computer that was sitting on somebody's desk, I will go as far as saying they had cobwebs on it while they were sitting over here with a card catalog kind of situation. Are they going to try, or do you know, the existing equipment that is there—it seems to me if you have spent this money over the years in putting these systems in, that you ought to be trying to integrate them into the program instead of just disregarding them.

All can I see is a 60 Minute report that shows some dump with all of these computers sitting out there, and I think that is a very poor way for us to do that. But I think it would come——

Mr. DUNN. I would agree with the Congresswoman. I am upset when I see some very expensive paperweights sitting on these desks out there. We need to train our individuals to ensure they know how to access and use the technology that is part and parcel of it, and we are designing that into this formula as well.

My goal in the future is to have a paperless office, to be able to go in there and have everything transferred electronically. Will that happen in the tenure I am down there? I don't know, but we are going to make steps in that direction.

Mrs. THURMAN. Thank you.

Mr. CONDIT. Thank you very much, Mr. Dunn. Thank you very much. We appreciate your being here. We appreciate your patience. We will leave the record open for you to submit the additional information.

Mr. CONDIT. We will take panel three. Mr. Murray, Mr. Watts, Mr. Campbell. Remain standing so we can swear you in.

[Witnesses sworn.]

Mr. CONDIT. Thank you very much. Mr. Murray, thank you for being here. Thank you for waiting the entire time. We appreciate it very much.

STATEMENT JAMES E. MURRAY, PARTNER, BROWN AND WOOD, FORMER PRESIDENT, FANNIE MAE

Mr. MURRAY. Thank you, Mr. Chairman. I submitted a statement to the subcommittee, and instead of reading that statement, I will just try——

Mr. CONDIT. I am sorry, I didn't introduce who you are with.

Mr. MURRAY. Yes. My name is James E. Murray. I am a partner in the law firm of Brown and Wood, president here in the Washington office. Brown and Wood is a large firm. One of their specialties is the mortgage-backed security area and asset-backed securities.

My background is that I was senior vice president, general counsel of Fannie Mae from 1970 through 1981, and I was President of Fannie Mae from 1981 until 1983. After that, I left Fannie Mae, I joined the law firm of Brown and Wood.

With that background, I am very familiar with the way the private sector handles the servicing of residential mortgages, and I would like to briefly describe how that is done, and then comment on the Farmers Home Administration portfolio.

Fannie Mae, Freddie Mac, and Ginnie Mae are the three main government-sponsored agencies which are major factors in the residential mortgage market. Those three agencies purchase and guarantee mortgages that are originated by lenders throughout the country, and in most—nearly all situations, the originator of that mortgage will then service the mortgage on behalf of the agency.

Another increasingly important part of the residential mortgage market are conduits which are formed generally by investment banking firms, and those conduits will also purchase mortgages. They will put those mortgages into trust or special purpose corporations and then issue securities, mortgage-backed securities.

I am also familiar with some other government agencies that have a similar kind of portfolio. I am specifically referring to the Small Business Administration. Under sections 303 and 504 of the Small Business Investment Act, SBA guarantees small business loans that are made by investment companies, and by development companies.

In those situations, those loans are put into a trust, the same way that a conduit would do it, and securities are issued from that trust, and those loans are serviced by a central servicer.

It seems to me this is one of the closer analogies to the Farmers Home Administration portfolio. When the Farmers Home Administration engaged in the sale of the Farmers Home Administration portfolio back in 1987, it was necessary to obtain ratings of those securities by rating agencies, and so a structure was developed under which those loans were sold and serviced, and again, that form of structure took what very much resembles the conduit form of structure. Trusts were formed, securities issued out of the trusts, and then a master servicer was appointed to service those loans, and of course all of that was intended to obtain a rating for the securities, and those ratings were given by the national rating agencies.

I have also worked for Farmer Mac, the Federal Agriculture and Mortgage Corporation, and know their programs. They began operations several years ago, and they also have adopted this sort of conduit form of issuance of securities, securities in which they guarantee the payment of principal and interest.

Farmer Mac has also developed a secondary market for the Farmers Home guarantee mortgages, and that also operates on a similar basis using a central servicer.

In summary, really the private sector generally consisting of the government-sponsored agencies and the conduits have adopted the practice of permitting the servicing of their portfolios that they either purchase or guarantee by the private sector. None of those agencies has attempted to service those loans directly, and in the case of conduits, and the situation in which Farmers Home Administration sold its loan portfolio, it also adopted the practice of using a central servicer.

It would certainly seem that that is a feasible, desirable alternative for the Farmers Home Administration. I heard the testimony of Mr. Dunn, and I can recognize that there are certain servicing practices which would be unique to the portfolio, but it would seem that—it would be much more effective and efficient to centralize the servicing either within the agency or in a private central servicer, and leave the unique characteristics of the portfolio, those loans that require special care, with the agency, and that certainly can be done having a central servicer and a field servicer, splitting the activities so that the normal servicing activities, collecting principal and interest, paying taxes, those sorts of things, could be handled by a central servicer, and the unique parts of the servicing be handled by field servicers in the field offices.

That concludes my testimony, Mr. Chairman. I will be glad to answer any questions.

[The prepared statement of Mr. Murray follows:]

STATEMENT OF

JAMES E. MURRAY

BEFORE THE SUBCOMMITTEE ON INFORMATION, JUSTICE, TRANSPORTATION AND AGRICULTURE OF THE GOVERNMENT OPERATIONS COMMITTEE OF THE HOUSE OF REPRESENTATIVES
FEBRUARY 9, 1994

Mr. Chairman, thank you for the invitation to appear this morning on this panel on the subject of servicing of the Farmers Home Administration ("FmHA") loan portfolio.

My name is James E. Murray and I am a Partner in the law firm of Brown & Wood, resident in the Washington Office. I have been a Partner in the law firm of Brown & Wood since January, 1983. From 1970 until 1981, I was Senior Vice President and General Counsel of the Federal National Mortgage Corporation ("Fannie Mae") and from 1981 until 1983, I was President of Fannie Mae. During my years of service at Fannie Mae and subsequently in my private practice, I have been an active participant in the creation of secondary markets for residential mortgages, agricultural credits and small business loans. I have represented the Federal Agricultural Mortgage Corporation ("Farmer Mac") in its efforts to create a secondary market for agricultural loans and in that federally-sponsored agency's operation of a secondary market for loans guaranteed by the Farmers Home Administration.

With this background, I am very familiar with the manner in which a variety of types of loans are originated by mortgage lenders and how those loans are serviced.

It is my understanding that as of June 30, 1993 FmHA held approximately $18.8 billion in direct loans that were made to over 690,000 single-family housing borrowers. These loans are being serviced by FmHA through approximately 1700 county offices.

From my discussions with the staff of the Subcommittee, the issue which is of prime concern to the Subcommittee is whether the FmHA portfolio could be more efficiently and effectively serviced in another manner. Specifically, should FmHA centralize the servicing functions or transfer such functions to a central servicer in the private sector?

First, I will describe what servicing of a single-family mortgage entails. Servicing covers a broad range of activities concerning the FmHA loans. It includes but is not limited to the following:

1. Collection of payments of principal and interest from the borrower;

2. Collection of tax and insurance escrow payments;

3. Insuring that taxes are paid and appropriate insurance coverage is maintained;

4. Maintaining proper loan files and servicing records;

5. Handling transfers of property, partial releases and payments in full;

6. Resolving delinquencies, foreclosures or workouts; and

7. Managing and liquidating acquired or abandoned property, including advancement of taxes and insurance premiums and expenses of property protection.

The servicing practices of the other major participants in the single-family mortgage markets are instructive in trying to determine what is an appropriate servicing practice for the FmHA portfolio. Principally, those institutions are Fannie Mae, Federal Home Loan Mortgage Corporation ("Freddie Mac"), Government National Mortgage Association ("Ginnie Mae") and a variety of private conduit institutions operated by investment banking firms. The servicing practices of Fannie Mae and Freddie Mac are essentially the same. Originators of mortgages sold to one or the other of the two institutions are serviced on behalf of either Fannie Mae or Freddie Mac. Servicing functions are performed by the servicer under the supervision of Fannie Mae or Freddie Mac pursuant to

servicing guidelines required by each institution. In the case of Ginnie Mae, the mortgage loans underlying the pool of mortgages upon which the Ginnie Mae guarantee is placed are serviced by originators pursuant to Ginnie Mae servicing guidelines. The servicing practices of Fannie Mae, Freddie Mac and Ginnie Mae are relevant to the Farmers Home portfolio on the point that none of these institutions attempts to service the mortgages it purchases or guarantees. The servicing remains either with the originating lender or a servicer approved by Fannie Mae, Freddie Mac or Ginnie Mae.

The Farmers Home portfolio presents a closer conceptual relationship, relative to the servicing of those loans, to a mortgage loan conduit in the private sector.

In the case of a private conduit, loans are originated by a variety of originating institutions. The loans are aggregated by a central conduit vehicle (which is usually a trust or single-purpose corporation) that is responsible for pooling the loans and issuing securities backed by the pool of loans. The resulting securities generally are rated by one of the nationally-recognized rating agencies. The loans in the pool are serviced by a central servicer and all of the servicing functions are performed by that central servicer.

There are situations in which servicing functions may be divided among a central servicer and designated field servicers. In that situation, a central servicer would receive payments of principal and interest, maintain tax and insurance escrows, make advances for late payments, taxes, insurance premiums and expenses of property protection and act upon the recommendations of the field servicer for workouts, foreclosures or other resolutions of delinquencies or defaults. The field servicer would maintain personal contact with the borrower, inspect the property and monitor the borrowers compliance with the note, mortgage or other loan documents. In the event of a delinquency or default, the field servicer would recommend a workout, foreclosure or other course of action, to the central servicer.

I am also familiar with several programs of the Small Business Administration which have, I believe, some analogies to the Farmers Home Administration program. Under Sections 303 and 504 of the Small Business Investment Act, SBA guarantees the timely payment of principal and interest on debentures issued by small business investment companies ("SBICs") and certified development companies ("CDCs"). The debentures issued by the SBICs and the CDCs provide financing for small businesses throughout the country. The SBICs and CDCs issue the debentures which are pooled by an agent of the SBA and certificates are issued representing beneficial interests in the pool. The certificates also are guaranteed by the SBA. In that situation, the agent for the SBA is acting in the role of the

conduit or the pooler of the loans. The servicing of the debentures is handled by a central servicer. After collecting payments from the small businesses financed by the debentures, the SBICs and CDCs forward those payments to the central servicer. While theses are small business loans rather than single family mortgage loans, the structure of the loan program bears a significant resemblance to the operation of the Farmers Home Administration program.

The sale of the Farmers Home Administration loan portfolio of 1987 essentially adopted the conduit structure outlined above. A series of rural housing trusts were created into which the farmers home loans were placed. Certificates representing beneficial interests in the trusts were issued and sold to the investing public. Subordinate interests in the trusts were retained by the Farmers Home Administration and subsequently sold as well. Manufacturer's Hanover (now Chemical Bank) was designated as the master servicer for the loan portfolio. That form of security structure was required in order to obtain the necessary investment grade ratings by the rating agencies. It would not have been possible to sell the senior investment grade certificates without a central master servicer to insure that payments on the loans were collected and forwarded to the trustee for distribution in payment of the interest and principal payments on the senior certificates.

Conclusion

The residential mortgage market, led by the activities of the government-sponsored agencies, Fannie Mae, Freddie Mac and Ginnie Mae, has become a highly liquid and efficient component of the captial markets. The agencies have relied upon the private sector to service the mortgages which they have purchased or guaranteed. In the case of private mortgage conduits, the most effective and cost-efficient servicing structure has been the use of a master or central servicer.

Mr. Chairman, thank you again for the opportunity to assist the Subcommittee in its examination of the servicing of the FmHA portfolio. I will be happy to answer any questions you may have.

Mrs. THURMAN [presiding]. Thank you.
Mr. Watts.

STATEMENT OF A. RUSSELL WATTS, SENIOR VICE PRESIDENT, CHEMICAL RESIDENTIAL MORTGAGE CORP.

Mr. WATTS. Thank you. I have submitted testimony for the record. I have a short summation of my written testimony.

My name is Russell Watts, and I am senior vice president of Chemical Residential Mortgage Corp. in Deerfield Beach, FL.

I am pleased to be here to discuss the Farmers Home section 502 portfolio. Chemical Residential Mortgage Corp. has been servicing section 502 housing loans for nearly 5 years.

I believe we are in a unique position to comment on the benefits, both to the borrower and the government, of centralization.

The mortgage servicing system that we have developed and continually enhance enables our employees to administer the complex Farmers Home assistance programs, escrow administration, and the range of other typical customer services in an efficient and cost effective manner.

We continually strive to provide high-quality customer service and believe our efforts have been successful. In a recent borrower opinion survey, for example, 93 percent of our borrowers said we exceeded their expectations for quality service, 50 percent graded us as excellent.

To illustrate some of the advantages of servicing in a centralized environment, it is instructive perhaps to look at the loans that were transferred to us from the Farmers Home in 1989. For example, key borrower data was not resident on the Farmers Home's system. When the loans were transferred to us in 1989, key information was not available on Farmers Home system records that were transferred. For example, critical data such as the loan balance, payment due dates and customer telephone numbers and addresses were not resident on their system.

The data had to be extracted from paper files which were poorly documented. Some information was calculated or obtained from third parties. Without such information, it would have been impossible for to us service these loans properly.

Second, there were millions of dollars in delinquent, unpaid taxes. The Farmers Home did not keep tax records for their borrowers. As we established tax records, we found that many, many borrowers had serious tax arrearages.

During the first 2 years we serviced this portfolio, we advanced over $30 million of government money to bring tax arrearages current. Nearly 38 percent of our borrowers had serious arrearages.

During the first 2 years, left unattended, penalties would have compounded and eventually properties would have been lost to tax sales.

Moreover, there is a high correlation between borrowers with serious tax arrearages and delinquency. Historical delinquency rates for borrowers with tax arrearages is 35.43 percent in our portfolio. Typically tax advances are capitalized, the borrower's payment is rescheduled and increased, with the result being a decline in homeowner equity and a more difficult monthly payment to meet.

A key element to reducing advances is establishing customer escrow accounts. We did so in 1990 and 1991. Today, all but 2.3 percent of the $30 million that was advanced has been collected as a result of establishing borrow escrow accounts, no further advances will ever be required.

Another example, the loans had high delinquencies as a result of either poor or no service. Because the standards for collecting delinquent accounts were administered from 1,900 county offices, we more or less received files reflecting 1,900 different methodologies for collecting delinquent accounts. They ranged from no evidence of collection to files that were poorly and inconsistently documented.

It was evident most always that a disciplined and systematic approach to collecting did not occur.

Servicing loans in a centralized servicing environment is normal in the mortgage industry today. The redundant costs and the almost incomprehensible managerial challenges associated with servicing large volumes in a decentralized environment would create a cost prohibitive, unmanageable, and unprofitable situation for any company.

Some of the most obvious benefits of centralized servicing include:

No. 1, service levels are consistently when administered. The functions and tasks performed in a mortgage servicing environment are so interrelated that in a decentralized environment, the depth of talent cannot possibly be deep enough to handle the full range of mortgage servicing duties required.

In a centralized environment staff are segregated by function and area of expertise. Escrow related questions are handled by escrow experts while the more complex questions about borrower assistance programs go to specialized loan counselors with skills to assist needy borrowers.

Both departments are aligned by common management with a common mission; to provide excellent service to customers. But the staff are different in their functional expertise.

Second, collection efforts are clearly focused with superior results. With an automated on-line collection management system and power-dialing technology, we can structure our collection efforts for maximum effectiveness. When managed centrally, goals can be carefully set and administered to ensure that collection efforts are successful.

By contrast, collecting loans in 1,900 county offices creates 1,900 styles of collecting, some of them effective and some not. We reviewed the collection efforts on thousands of delinquent files referred to us and found a multitude of styles, most of them poorly documented. We found the followup extremely poor. These problems don't occur in a centralized environment.

Third, the administration of borrowers' rights. One of the most important things we do in servicing these Farmers Home borrowers is to implement the borrowers' rights programs for the benefit of our customers.

When a borrower gets into financial difficulty, they require a knowledgeable expert who is capable of quickly assessing their needs and delivering service. Our expert representatives are avail-

able 10 hours a day to take toll-free calls from borrowers in financial difficulty with our sophisticated technology.

Our representatives can usually obtain enough information over the telephone, such as information about wages, debts, their employment status, et cetera, to create a budget on our computer system. While on the phone, we often can determine the amount of assistance a borrower is eligible for and immediately mail out an assistance package.

By contrast, Farmers Home borrowers must take time off from their work to visit Farmers Home offices and go through a slow, manual process to determine eligibility status. It is not only time consuming for the borrower, but fraught with error. Many of the borrower files that we received from Farmers Home reflected errors that were ultimately of negative benefit to the borrower.

Servicing in a centralized environment reduces cost. The economies of scale which exist centrally don't exist in a decentralized environment. There are natural redundancies built into a decentralized environment that are not in a centralized center.

Simply stated, it is cheaper servicing loans in one location than in multiple.

Careful management of the complex processes of foreclosure, asset acquisition and disposition is another process that can save millions when it is done centrally.

Foreclosure and property management are areas where losses soar, where there is poor performance.

The foreclosure process requires knowledge of State statutes and experience in working with and guiding foreclosure attorneys in completing timely and inexpensive foreclosures. REO management requires significant expertise in marketing distressed properties quickly and at the best possible price. These are disciplined and technical processes that would work poorly in a decentralized environment.

The Farmers Home administration has a national foreclosure rate of 2.10 percent. Our portfolio foreclosure rate is only .48 percent. Our strategy is always to ask the question, how do we avoid the foreclosure? This effort just can't be managed in a decentralized environment, in our judgment.

In point of fact, Farmers Home forecloses 4 times the percentage number of loans that we do.

As to the question of disadvantages in a centralized servicing environment, we don't really feel that there are any, but I do feel it is important to comment on the potential disadvantage that was noted in the September 1993 report by the GAO. Specifically, the lack of face-to-face contact.

In the 5 years that we have been servicing Farmers Home housing loans, we have come to know that borrowers aren't particularly interested in coming to visit with a representative face-to-face, but rather, they are interested in expedient and courteous service when they encounter financial difficulties.

Personalized service delivered by a caring, capable, and efficient representative in a county office is misleading because most often that service simply doesn't exist.

When a borrower needs to see a FmHA representative for assistance, they are required to take time off from their jobs and drive

often long distances for an appointment. Subsequently they must go through a slow manual process to determine their eligibility for assistance.

In a centralized environment our borrowers can call us on a coffee break, their lunch break, or in the evening when they arrive home, and the call is toll-free. In fact the busiest time of the day for our counselors is between 5 and 7 p.m.

Our counselors are expert with the Farmers Home regulations. After a few short minutes of dialog with one of our counselors, we can provide the maximum amount of assistance available within the guidelines. The assistance packages are totally automated and following a customer call, a package is mailed the next morning. This is streamlined, hassle free, and a highly customer friendly process.

Any of our Farmers Home customers, I think, would gladly report it is easier dealing with a knowledgeable representative on the telephone in the privacy of their own home than it is with the manual procedure, particularly if it involves a long drive.

While face-to-face contact sounds good, we believe differently. We have the expertise to demonstrate that such a statement is correct.

In conclusion, we believe that we have achieved superior results with our 502 portfolio. By using most any measurable benchmark as well as by listening to our customers, we provide a level service that would be considered excellent in any organization.

The success we have achieved could never have been accomplished in a widely decentralized environment like the county office structure. Moreover, all that we do in our office is service loans. The county offices perform a variety of services. Administering escrow accounts in a decentralized environment would be a nightmare in our judgment.

We have estimated that potentially billions in cost savings are available over 5 years using the private sector to service Farmers Home loans. CRMC could begin to service more loans immediately, but any private sector company would be faster and more efficient than Farmers Home.

Developing the technology and especially the expertise of the staff takes time. The private sector has a big leg up, they already have the people expertise and the Farmers Home does not. The private sector also has most of the technology Farmers Home does not. CRMC has all the technology, expertise, and people.

At a minimum, we feel giving the private sector an opportunity to compete with Farmers Home might be valuable. A better and more informed long-range decision might be reached through a little healthy competition.

Thank you again for giving me the opportunity to speak.

Mr. CONDIT. Thank you, Mr. Watts.

[The prepared statement of Mr. Watts follows:]

Testimony of

A. RUSSELL WATTS
SENIOR VICE PRESIDENT
CHEMICAL RESIDENTIAL MORTGAGE CORPORATION

on

CENTRALIZED SERVICING OF FmHA's
SINGLE FAMILY HOUSING PORTFOLIO

before the

GOVERNMENT OPERATIONS COMMITTEE
SUBCOMMITTEE on INFORMATION, JUSTICE,
TRANSPORTATION and AGRICULTURE

U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.

FEBRUARY 9, 1994

Chemical Residential Mortgage Corporation (CRMC)
Deerfield Beach, Florida

CRMC'S HISTORICAL DEVELOPMENT

The Omnibus Budget Deficit Reconciliation Act of 1986 required the Farmers Home Administration to Sell Section 502 (Housing Act of 1949) mortgage loans from two of its portfolios. The sale, as required by OBRA, had to be accomplished during the government's fiscal year ending September 30, 1987. The loan sale also required FmHA to transfer the servicing of the mortgage loans to the private sector. In September, 1987 the sale of 141,353 mortgage loans with an approximate aggregate outstanding principal balance of $3.0 billion was completed and the loans were sold to the Rural Housing Trust 1987-1. Following the sale, the FmHA continued to sub-service the loans on behalf of the Trust for a period of two years. Pursuant to the loan sale guidelines their role as sub-servicer was not to exceed that time period.

On August 3, 1988, Manufacturers Hanover Servicing, Inc. (now Chemical Residential Mortgage Corporation - "CRMC") was incorporated. CRMC is a wholly owned subsidiary of Chemical Banking Corporation, and the company was chartered to service the FmHA mortgages for the Trust. From this date CRMC began the process of developing the systems, facilities and staff to service these loans. The conversion and transfer of the Trust loans began in May, 1989 and was completed in August, 1989. In total, 130,000 loans at approximately $2.9 billion were transferred to CRMC from the FmHA.

During the last five years CRMC has become expert in the servicing of these highly specialized loans. The development of the current servicing system has been an evolution of technology and staff development.

The mortgage servicing system that we have developed and continually enhance enables our employees to administer the complex "Borrower Rights" programs of the FmHA in a fully automated center. We provide high quality customer service (May 1993 CRMC Borrower Opinion Survey reflected a 93% borrower satisfaction rate) in a cost effective environment.

Since assuming the servicing responsibilities in 1989, CRMC has successfully hurdled a number of difficult obstacles that resulted from the manner in which the loans were serviced by the FmHA. Some include:

1. Reduced high delinquencies. Our current fully escrowed portfolio rate of delinquency is 7.37% vs. FmHA National Portfolio rate of 16.07% which is not escrowed.

2. Significantly reduced the rate of foreclosures. Our current rate is .48% as compared to FmHA's 2.10%.

3. Established Borrower Escrow Accounts. Among other benefits, establishing escrow accounts eliminated a $30 million government liability that resulted from government advances to pay unpaid property taxes on these loans.

4. Established all borrower account records on our data processing system. The Farmers Home Administration data processing system was absent some of the most critical data necessary to properly service customers (for example, borrower payment amount, loan due date, loan balances). We have created sophisticated customer account records for 130,000 borrowers. We can respond to borrower needs quickly and efficiently.

All of our efforts and the outstanding success we have had with our portfolio are achieved in a centralized location. As evidence, we recently received an annual audit report from the FmHA subsequent to their review of our loans. After an exhaustive review of our portfolio of nearly 100,000 loans in forty-seven states, the FmHA found no deficiencies or errors.

The following pages reflect a more comprehensive discussion of the benefits of servicing loans in a centralized loan servicing environment.

CENTRALIZING THE LOAN SERVICING FOR THE FmHA NATIONAL PORTFOLIO A SUPERIOR ALTERNATIVE

As a point of reference, the FmHA services approximately 700,000 housing loans from 1,700 County offices nationwide. No private sector servicing company in the United States services loans on a decentralized basis. At best a small number of the largest servicers in the United States operate two service centers. The redundant costs and almost incomprehensible managerial challenges associated with servicing large volumes in a decentralized environment would create a cost prohibitive, unmanageable and unprofitable environment for any private sector company.

We believe there are significant benefits associated with servicing FmHA Housing Loans in a centralized environment. Having established our company to service FmHA loans and having serviced a large portfolio for over five years, we believe our

expertise is unique. Our experience with this complex product and "high needs" borrower leads us to conclude that more than any other product, servicing FmHA loans takes a disciplined and focused effort not possible in a decentralized environment.

To illustrate some advantages of managing in a centralized environment, it is instructive to look at the loans that were transferred to CRMC in 1989. The FmHA servicing environment is the same today (decentralized) as it was in 1989 so the problems illustrated herein may still be evident.

FmHA System Does Not Account For Key Borrower Data. When the FmHA loans were transferred in 1989, the FmHA system did not contain such critical information as: Loan Balance, Loan Interest Rate, Payment Amount and Payment Due Date. All of this critical borrower data had to be calculated and/or manually extracted from the paper files.

Millions Of Dollars In Unpaid Property Taxes. When CRMC acquired the portfolio of 130,000 loans from FmHA, these loans were transferred without tax records. A special fund was established as part of the loan sale (funded by the Government) to pay delinquent taxes. Following is a synopsis of our experience.

Description	Date	Delinquent Tax Advances	Net[1] Delinquent Tax Advances
· Portfolio Acquisition	5/89	$179,569	$179,569
· Year End 1989	12/89	12,311,892	10,218,646
· Year End 1990	12/90	18,591,912	8,776,116
CRMC begins to establish escrow accounts for borrowers in June 1991. The process takes (1) year.			
· Year End 1991	12/91	$28,582,000	$7,612,442
· Year End 1992	12/92	30,052,009	2,446,600

In four (4) years CRMC advanced over $30,000,000 to pay delinquent property taxes which borrowers had failed to pay and FmHA failed to manage. Left unattended, penalties would have compounded, eventually properties would have been lost to tax sales. As the result of establishing borrower escrow accounts, the balance has declined and in 1994 has been reduced to near zero. All but 2.3% has been collected. No further advances will ever be required.

[1] *Net of dollars collected to reduce the advance. Includes collections plus charge-offs. Over (4) years charge-offs totaled $698,946 (2.3%).*

Presumably the current national FmHA portfolio has similar unpaid tax liabilities as did the portfolio we acquired. In our judgement, hundreds of millions of dollars are currently at risk. Left unattended unpaid taxes and related penalties will eliminate borrower equity and greatly increase the government's liability.

By simply extrapolating based upon the funds advanced by CRMC, the FmHA national portfolio could have unpaid tax liabilities totaling $161,000,000. Beyond the apparent liability, these unpaid taxes greatly impair the borrowers ability to pay off their mortgage debt, compounding losses.

To our knowledge the present FmHA strategy of not tightly managing delinquent property taxes is unchanged. Advances for delinquent taxes (amortized advances) continue, increasing the government's liability.

There is a very high correlation between unpaid taxes and delinquency. The overall average portfolio delinquency rate for the direct FmHA loans serviced by CRMC is approximately 7.37%. All of our borrowers have escrow deposit accounts established. The historical delinquency rate for borrowers with delinquent tax advances is 35.43%. Typically, delinquent tax advances are capitalized and the borrowers payment is rescheduled. The monthly principal and interest always goes up ultimately reducing the borrowers ability to repay the mortgage. The most important element to reducing delinquent tax advances is to place borrowers on an escrow status thus eliminating any potential for a delinquent tax to occur. Presently the FmHA does not have the technology, people and business "know-how" to establish an escrow administration system. As noted, one pilot program to do so has already failed.

<u>High Delinquencies As The Result Of Poor/No Service</u> When the loans were sold into the Trust in 1987, the FmHA was obligated and did sub-service those loans for two years on behalf of the Trust. In 1989 CRMC took over the servicing responsibilities. When the loans were placed into the Trust they were required to be current (no delinquency) yet two years later when they were transferred to CRMC the delinquency rate had ballooned. Today the FmHA rate is 16% . By applying a disciplined collection management effort CRMC has reduced the delinquency rate to a two year average rate of 7.37% and the portfolio is fully escrowed. At the same time, FmHA's foreclosure rate is four times CRMC's. Our rate is .48% while FmHA's rate of foreclosure is 2.10%.

Servicing loans in a centralized loan servicing environment has many benefits and few if any negatives. The major benefits have been recognized in the private sector for years and the result is that no company services loans on a decentralized basis. Some of the most obvious benefits include:

Service Levels Are Administered Consistently. In our experience with FmHA we have found that county service levels vary greatly. While many offices provide good service, many provide very poor service. Something as simple as implementing a new regulation becomes very complex in a decentralized environment simply because offices often interpret complex regulations differently. By contrast, we have a training center in our facility. When regulatory (FmHA, RESPA, other) changes occur, they are consistently implemented and managed.

Collection Efforts Are Clearly Focused With Superior Results. With an automated on-line collection management system and power-dialing technology we can structure our collection efforts for maximum effectiveness. When managed centrally, goals can be carefully set and administered to ensure that collection efforts are successful. By contrast, collecting loans in 1,700 offices creates 1,700 styles of collecting, some effective, some not. We reviewed the collection efforts on thousands of delinquent accounts transferred to CRMC and found a multitude of styles, most poorly documented. We found follow up to be very poor. These problems don't occur in a central collection office. Our historical average delinquency rate is 7.37% vs. the FmHA rate of 16.07%.

Superior Administration Of "Borrowers Rights". One of the most important things that we do in servicing FmHA borrowers is to implement the "Borrowers Rights" programs for the benefit of our customers. When a borrower gets into financial difficulty they require a knowledgeable expert who is capable of quickly assessing their needs and delivering service. Our expert representatives are available ten hours a day to take toll free calls from borrowers in financial difficulty. With our sophisticated technology, our representatives can usually obtain enough information over the telephone (wages, debts, employment status, savings) to create a budget on our computer system. While on the phone, we often can determine the amount of assistance a borrower is eligible for and immediately mail out an assistance package.

By contrast, FmHA borrowers must take time off from their work to visit FmHA offices and go through a slow, manual process to determine eligibility status. It is not only time consuming for the borrower, but fraught with error. Many of the borrower files that we received from FmHA reflected errors that were ultimately of negative benefit to the customer.

Servicing In A Centralized Location Reduces Cost. The economies of scale which exist centrally don't exist in a decentralized servicing environment. There are natural redundancies built in to a decentralized environment that are not evident in a centralized center. Costs related to redundant managerial and supervisory positions as well as space, telephone, and other inefficiencies do not exist in a centralized servicing facility. Stated simply, it is cheaper servicing loans in one location than it is in multiple locations.

Careful Management Of The Complex Processes of Foreclosure, Asset Acquisition And Disposition Saves Millions. When foreclosure becomes necessary, having the expertise and technology to manage loans rapidly through foreclosure and then to quickly dispose of properties at the highest possible price limits losses. Foreclosure and property management are areas where poor performance can cost millions.

The foreclosure process requires knowledge of state statutes and experience in working with and guiding foreclosure attorneys to complete timely and inexpensive foreclosures. REO management requires significant expertise in marketing distressed properties quickly and at the best possible price. These are disciplined and technical processes that would work poorly in a decentralized environment.

The Farmers Home Administration has a national foreclosure rate of 2.10%. By contrast, our portfolio foreclosure rate is only .48%. We have a highly focused effort geared to keeping borrowers in their homes. Every loan foreclosed must pass through a committee of CRMC officers before finally deciding to foreclose. The strategy is always "how do we avoid this foreclosure?". Such an effort simply cannot be managed on a decentralized basis. In point of fact, FmHA forecloses four times the percentage number of borrowers that CRMC forecloses.

When a loan is foreclosed, the faster the property is disposed at the highest possible price limits the losses incurred on the property. Again, we believe asset management is performed better centrally provided it is supported by an expert staff and systems. The following illustration reflects the difference between our efforts and those at FmHA. FmHA's percent of real estate owned assets is nearly four times CRMC's. The cost differential on their 700,000 loan portfolio is $104,000,000.

CRMC Generated Cost Improvement From Efficiently Disposing of Foreclosed Real Estate Owned (REO)

	CRMC	FmHA	SAVINGS
Number of Loans	700,000	700,000	700,000
REO %	.39%	1.49%	1.10%
Number of REO's	2,730	10,430	7,700
Average REO Cost/Loss[2]	13,500	13,500	13,500
Total Cost/Loss	$36,855,000	$140,805,000	$103,950,000

2 *Assumes costs/losses are equal for illustration purposes.*

DISADVANTAGES TO CENTRALIZED SERVICING

While we do not feel that centralized servicing creates any disadvantages, we do feel it is important to address the two disadvantages that were noted in the September, 1993 GAO Report on centralized FmHA Servicing. In particular, the perceived disadvantage created by the decrease in face-to-face contact between borrower and lender.

In the five years that CRMC has serviced FmHA housing loans we have come to know that borrowers are not particularly interested in visiting with a representative "face to face" but rather, they are interested in expedient and courteous service when they encounter financial difficulties. Personalized service delivered by a caring, capable and efficient representative in a county office is misleading because most often that service does not exist. When a borrower needs to see a county representative for assistance they are required to take time off from their job and drive (often long distances) for an appointment. Furthermore, the manual process that is completed in the county office is slow.

In a centralized servicing environment our borrowers can call us on their coffee break, lunch break or in the evening when they arrive home, <u>the call is toll free</u>. The busiest time of the day for our borrower counselors is between the hours of 5:00 p.m. to 7:00 p.m. We staff our phones with counselors who are experts in FmHA Regulations and the various borrower assistance programs. Almost always, after a few short minutes of dialog, we can provide the maximum amount of assistance available within the guidelines. The assistance packages are totally automated and following a customer call the package is mailed the next morning. This is a streamlined, hassle free and highly customer friendly process. Any FmHA customer having dealt with CRMC would gladly report that it is easier dealing with a knowledgeable representative on the telephone from the privacy of their home than it is to accomplish this through a manual procedure. While face to face contact sounds good because it implies that it delivers "more customer caring", we believe differently and we have the experience to make such a statement.

Following are some direct quotes from a recent Borrower Survey (October, 1993).

> *"We had experienced financial difficulties and CRMC representatives practically bent over backwards to help us. We will never forget their assistance in helping us to keep our home."*

Eileen Hummer
New Jersey

Chemical Residential Mortgage Corporation (CRMC)
Deerfield Beach, Florida

"CRMC has well earned a big "Thank You" for helping me through a financial crisis and enabled me to keep my home. I hope I have been as good of a borrower as you've been a loan company".

Terry L. Reeves
Oregon

"You have helped me so much since my husband's death. I can not put into words how I feel about Chemical Residential Mortgage."

Flecia Stalnecker
Georgia

"Your company has helped me a great deal in my time of financial difficulty. I have never dealt with a company that is so understanding and helpful. My thanks go out to Mr. B. Silvers and her fellow workers."

Orise & Linda Couvillion
Louisiana

"We, as senior citizens appreciate your patience and understanding when we get confused on how to fill out forms. We think you're great."

Russell & Ethel Smith
Virginia

"This is my honest opinion, I would rate this company #1 above all others in the country. Thank you."

Dorothy Epps
North Carolina

The second point made in the GAO's report is the need for a major redevelopment and redesign of automated systems. This is accurate and on-point. In fact, not only will FmHA have to design systems they will have to develop the staffing expertise. In testimony before the Agriculture Sub Committee on Conversion, credit and Rural Development (October 29, 1991) the GAO (Report #GAO/T-IMTEC-92-2) reported that the FmHA implemented a $520 million information systems modernization in 1974 that is not complete today. The report notes:

"A history of failure. This is the FmHA's third modernization attempt since 1974." The first attempt terminated in 1979, incomplete, the second attempt terminated in 1986, incomplete. FmHA's prior modernization attempts failed in part because the agency did not effectively oversee the projects. For instance FmHA recently purchased $32 million in computers for its field office without first preparing the analysis needed for effective management control. "FmHA needs to re-think its approach to modernizing its information systems. FmHA is spending hundreds of millions of dollars to modernize systems that support its loan programs before it has clearly articulated a business vision and supporting information needs".

The private sector is years ahead of the FmHA in staff development and systems. Most large companies could develop capacity much faster than the FmHA. In CRMC's case, we could service more FmHA housing loans immediately. We don't believe it makes sense to spend millions of taxpayer dollars to develop a servicing capacity in the FmHA when hundreds of millions have already been wasted on a function which is arguably better conducted in the private sector.

CONCLUSION

There are a myriad of reasons why servicing FmHA loans from a centralized service center is more prudent than in the current environment at the FmHA. We have built our business around servicing FmHA direct housing and guaranteed housing loans . We understand this product better than any private sector company and arguably better than most people within the FmHA. It is because we are experts with this loan product that we believe our conclusions are fair and accurate.

Our staff is focused fully on servicing whereas FmHA staff must complete a variety of tasks; servicing is only part of their job and it is only logical that if their efforts are not focused upon servicing they will not function as well as would a fully dedicated operation.

We understand that FmHA is currently moving into a more consolidated environment where regional "one stop shopping" offices will become the norm. These centers will be responsible for loan making and loan servicing over various product lines. In our judgement this concept may create even greater servicing challenges than the current environment. In particular, if Farmers Home continues to require face to face contact to administer assistance programs customers will now be relegated to traveling greater distances to visit in person with FmHA representatives. This approach is simply not customer friendly.

Graduating eligible borrowers into the private sector or into the FmHA Guaranteed Housing Program[3] could also be better accomplished centrally. Developing techniques for identifying eligible borrowers and using a systematic and disciplined approach to graduate borrowers will free up million (or millions) of dollars for more needy borrowers. This effort is haphazard at best as it is presently organized.

We appreciate the opportunity to testify and would be available to provide more information in the future.

[3] *Presently the Guaranteed Housing Program cannot be used for borrower refinances. We believe there are several billion dollars of high coupon direct housing borrowers who cannot qualify for conventional credit and so are "trapped" in very high rate FmHA direct housing mortgages. Many of these borrowers could likely qualify for Guaranteed Housing loans if FmHA allowed borrowers to refinance into the Guaranteed program.*

Mr. CONDIT. Mr. Campbell is the chair of the Housing Assistance Council. We appreciate your being here, sir. Thank you.

STATEMENT OF ARTHUR C. CAMPBELL, CHAIR, HOUSING ASSISTANCE COUNCIL

Mr. CAMPBELL. Thank you, Mr. Chairman.

I am Art Campbell, from Chattanooga, TN. I am a member of the county board of commissions there. I was also area director of Farmers Home in 1978 to 1981.

But I am here today on behalf of the Housing Assistance Council in my role as chairman of the board of directors of HAC. HAC is a national nonprofit organization that supports rural housing development. It works in 48 States, and it has really helped develop about 25,000 affordable houses.

We are very interested in and work very regularly with the Farmers Home Administration. In fact, as you know, they are the principal source of housing finance for low-income people. We were, with that background, very interested to see the GAO's report on this issue. I appreciate this opportunity to comment on that report, and also on this issue.

HAC is really persuaded that the only decision we think ought to be made now involves the centralization of the tax and insurance escrow decision. That is the only decision we think ought to be made at this time. We believe that other changes ought to be made in consideration of what actually transpires with reorganization and restructuring.

Our major concern is that any reorganization also include a localized delivery system. The restructuring as proposed, we think, will end the dual farmer housing role. We think that will help mitigate some of the concerns that were raised in the GAO report.

We think that Farmers Home should be required to implement promptly the escrow system. It is our strong opinion that the agency could expedite this if it would modify its own accounting procedures and adopt escrow software that is currently being used in the private sector.

The Chemical Bank Residential Mortgage Corp. converted ex-FmHA borrowers to escrow. We don't think there is any reason why Farmers Home can't follow a similar path to do the same thing. We think the computer compatibility issues that have been raised really should not be held up as an excuse or an obstacle to this being done.

I was on the transition team last year, I looked at the Farmers Home Administration, I was in charge of that, and I appreciate the gravity of those problems and the depth of the problems with the computer system, the amount of moneys that have been spent on that. But I still don't think that ought to be an excuse for this not being done by the agency.

There are a number of side issues that this centralization of proposals really raises. We think it ought not be used to eliminate FmHA field offices that are really necessary to provide access to housing and grant application by low-income families.

I think this is a very important point, that's not just the servicing of the loans, but it is also the loan making that takes place out

there in those rural places. We don't think that the office that has dealt solely with housing ought to be arbitrarily eliminated.

And I suspect that is part of what goes into that 500 or so reduction that we have proposed, that Mr. Dunn was talking about. And we also think that any centralized servicing ought be done by the agency. It ought to be done by Farmers Home and not contracted out.

We think that that is really necessary if you are to maintain the combined focus of loan making and loan servicing, that in many cases you won't have the rationale to have an office in these locations if in fact you split these functions, the loan making and the loan servicing functions.

Now, I would also say, and it goes to the point the previous speaker raised about the toll-free lines, we really think that low-income borrowers participating in the centralized computerized system really need to have a human face with which to consult in a time of crisis. I work the phone pretty good. I use a toll-free line. But I can tell you, and I have traveled the length and breadth of rural America in the south, at least, and I grew up in rural America, in the south, and I remember when we got electric lights and didn't have indoor plumbing and all of that. It is a big task for a person to even go into a Farmers Home office.

I think that you would get the same level of servicing by people who would pick up a phone and use a toll-free line and punch button 7 and button 10 in order to get to the right person to address a problem that someone has is a misconception of what really would happen in that case.

I recognize that that may be a backward looking kind of statement in a sense that we ought to be forward looking in how we bring people into the new age of using those kinds of systems. But I think that is a problem that we ought recognize that we would have.

The other point I want to make is that we really believe that the social purpose is difficult to measure in specific dollars, but the reality is it ought to be factored into the cost of operating social programs. I think we have to ask ourselves what business are we in, and the business we are in is in providing houses to the poorest of the poor.

And that is to say and I am not suggesting this, that you cannot bring business practices and business accountability to that mission. But I think we ought to understand that we stick with that mission and not move out of that equation for the social purpose.

Now, I will just give you one example where I think the social purpose has been somewhat minimized, that is in the FmHA guaranteed loan program. The regulations of that program exempted the participating lenders from certain legal protections that were provided in the Housing Act of 1949. Two of those I would say is the right to appeal and the right to moratoria. They are exempted under the guaranteed loan program.

Now, I understand that the guaranteed loan programs have a low budget mark, and I understand they are popular for that reason. But I think that part of the risk we run on this is that we ought to return to the business that we are really in. That is social purpose we have.

I would also like to add a comment about the unique place of the single family home ownership in rural America and Farmers Home's role in that pattern. It is something that you raised earlier, Mr. Chairman, to the first panel, about the relationship of this program to HUD programs.

Homeownership is more prevalent in rural America than urban America. Of rural homes 81 percent are owner occupied, as opposed to urban households, 23 percent of low income households are homeowners.

A goal of ours in this country since at least 1949 has been to promote homeownership for a wide range of Americans. I think Farmers Home has played a very substantial role to create the high level of low income homeownership.

I would suggest that all of us ought proceed very cautiously in changing that system, that really in large measure has worked.

So in summary, I am here to really ask you that we take no specific overt action at this time on this, but that we press Farmers Home, and that you press Farmers Home, to implement the escrow system, the taxes and insurance, and we wait awhile so that we know what is happening with restructuring and reorganization.

Thank you, very much.

Mr. CONDIT. Thank you.

[The prepared statement of Mr. Campbell follows:]

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Centralized Servicing for the FmHA Single Family Housing Program

Testimony by Arthur C. Campbell
Chair, Housing Assistance Council

Before the Committee on Government Operations
Subcommittee on Information, Justice, Transportation, and Agriculture
U.S. House of Representatives

February 9, 1994

Good morning. My name is Arthur C. Campbell. I am owner of the ACC Development Company in Chattanooga, Tennessee, and a member of the Hamilton County, Tennessee, Board of Commissioners. I also was an Area Director of the Farmers Home Administration from 1977 to 1981. Today I am speaking in my role as Chairman of the Board of Directors of the Housing Assistance Council (HAC). HAC is a national nonprofit organization that helps create more affordable housing in rural America. Since 1971, HAC has provided seed-money loans, technical assistance, training, research, and information to a wide range of public and private groups. HAC has helped build almost 25,000 affordable housing units in the rural parts of 48 states.

At HAC, we are very interested in and work regularly with the Farmers Home Administration's (FmHA) rural housing programs. They are a principal source of housing finance for low-income rural people. With this background, we were very interested to see the General Accounting Office report that is the subject of today's hearing. Mr. Chairman, we very much appreciate your invitation to testify.

While there are some compelling arguments for consideration of centralization of Farmers Home Administration single-family housing loan servicing, HAC is

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persuaded that only decisions involving centralization of a tax and insurance escrow system should be made at this time. We believe that any other changes must be made in consideration of what actually transpires with the proposed U.S. Department of Agriculture plan for reorganization and restructuring. As you know, this reorganization is now under consideration by the Agriculture Committees of the Congress. HAC is primarily concerned that any reorganization must include a localized delivery system to provide assistance for working low- and very low-income families seeking single-family housing loans and grants. USDA restructuring, as currently proposed, will end the dual farmer/housing role at FmHA and mitigate much of the concerns expressed in the General Accounting Office (GAO) September report. FmHA farm and housing programs will in all likelihood be split into separate new agencies.

HAC believes FmHA (and its successor agency for housing) should be required to implement promptly an escrow system. It is our strong opinion that the agency could expedite this if it would modify its own accounting procedures and adopt escrow models or software currently being used by the private sector. Chemical Bank Residential Mortgage Corporation successfully converted ex-FmHA borrowers (1986 asset sales) to escrow and there is no reason why FmHA cannot follow a similar course. The computer compatibility arguments, cited in the GAO report, are no excuse. HAC believes the agency must be required to move quickly to correct any technical impediments currently present in its own financial operations.

There are a number of side issues which arise from the centralization proposals. Our informed position on these issues is outlined as follows:

(1) Centralization should not be used to eliminate FmHA field offices necessary to provide access to housing loan and grant application by

low- and very low-income families. HAC rejects the notion that offices dealing almost solely with housing loans should arbitrarily be eliminated.

(2) Any centralized servicing should be performed by the agency and not contracted out. This is necessary to permit enough staff and offices to maintain a localized delivery system. Reducing federal staff and services through contracting with the private sector is not an acceptable procedure, because such an approach does not allow loan making and servicing together. Because of this it is our impression that contracting usually costs more in overall terms.

(3) Low-income borrowers, even those participating in a centralized-computerized system, should have a human face with which to consult in time of crisis. This has been one of the historic strengths of the agency. (Note: the FmHA portfolio is comprised of those most likely to be affected by economic downturn, or whose lack of reserves make them vulnerable to temporary financial stress).

HAC believes it is crucial that social purpose, often difficult to measure in specific dollars, be factored into the cost of operating social programs. The FmHA housing programs are socially oriented to those unable to obtain assistance from the private sector. The FmHA guaranteed Section 502 home ownership program is a good example of how social purpose is minimized or even abandoned in the drive to attain lower cost private sector participation. Regulations for this program have exempted participating lenders from certain legal protections in the Housing Act of 1949. These protections--the right to appeal and the right of moratoria--have been denied to loan applicants and borrowers in the Section 502 guaranteed program. Further, the law pertaining to how loans are liquidated is also ignored. The guaranteed loans have a very low budget mark and are thus popular with both

Administration and Congress. However, they serve a higher income clientele. HAC is very concerned that contracting out services to the private sector will gradually erode the very fiber of Title V which was intended to provide services and protections otherwise unavailable to low-income borrowers.

I also would like to add a comment about the unique place of single-family homeownership in rural America, and about Farmers Home's role in that pattern of tenure. Homeownership is much more prevalent in rural areas than in the cities. The 1991 American Housing Survey shows that 81 percent of rural homes are owner-occupied. Even among low-income rural people, 53 percent--1.98 million households--own their own homes. In central cities, only 23 percent of low-income households are homeowners. A principal goal of housing policy for decades has been to promote homeownership for a wide range of Americans. In rural places, FmHA has played a very substantial role in helping create a high level of low-income homeownership. We should proceed cautiously in altering this successful system.

Mr. Chairman and members of the Committee, we ask that you take no overt action at this time, other than to press FmHA to expedite a centralized escrow system for taxes and insurance. Thank you very much.

Mr. CONDIT. We thank all three of you for your fine testimony this morning.

Mr. Watts, I am told you disagree with the assessment that the loans purchased by your bank were the cream of the crop. Could you explain why you feel this way?

Mr. WATTS. I do. I disagree strongly. When these loans were sold into the private sector in 1987, there was a 2-year period between 1987 and 1989 during which the Farmers Home subserviced the loans, and in 1989 they were transferred to us.

On the date that those loans were sold in 1987, I believe that the cream of the crop definition probably comes about because these loans were supposed to have been current in terms of delinquency on that date, and to my knowledge they were.

But to respond directly to your question, when we began servicing these borrowers 2 years later more than 10,000 of the borrowers were two or more payments delinquent; 1 percent of them were in foreclosure. Earlier I mentioned in my testimony we had to advance approximately $30 million to bring taxes current. It turned out that 38 percent of our borrowers had serious tax attorneys.

Finally in our exploring more about these loans as we got more familiar with our borrowers, we found that historically over half of them had been on assistance at one point in time or another.

So I guess if you look at all those elements and say that these represent the definition of loans that were the cream of the crop, than we did indeed get it, but I suspect we probably got loans that were very similar to what is in the Farmers Home portfolio generally.

Mr. CONDIT. How is it, Mr. Watts, that your organization was able to implement the escrow program and the Farmers Home couldn't?

Mr. WATTS. I think it is called the Wisconsin project. What I know of the way that the implementation plan went about is it did not really merge well, the servicing of the loan and the servicing of the escrow. There are not two separate pieces, they are one and the same.

It is the same borrower, and it is the same set of concerns, you can't collect an escrow payment over here and a regular mortgage payment over here, and account for them separately and treat them differently.

What we did was we systematically decided, and it took us 6 months to figure out how best to do this, we systematically decided how to go about rolling escrow into the loan collection process that we already had on our books. That process was one which started with borrower education.

You have borrowers out there that didn't know what escrow was, they had never escrowed, as a matter of fact, we had borrowers who called us up and asked to talk to Mr. Escrow. We prepared borrower handbooks and sent them out months in advance. We had a 120-day window period from the time the first mailing went out to start to educate the borrowers about escrow, to the day we started their accrual, and it was all timed very specifically to the tax cycles.

Moreover, we had a system that was merging our escrow system with all of our other accounting systems, so we treated it all as one.

When the borrower mailed in a payment, it was transparent to them they were mailing an escrow payment for credit to credit their escrow account, their mortgage to credit their mortgage account. It was all one payment.

Finally, the dialog that went on for the 2 years afterwards, after the escrow process began, was enormous. I can't imagine focusing that kind of an effort in a decentralized environment. We have a system where every phone call and every borrower contact is recorded. In other words, a customer calls us and the phone reps are required to record that conversation on the screens. We can manage the type of calls that we get, we can forward them to the correct areas, and then we can start looking at the statistics that are driven off of those contacts and determine where we need to do better.

I can't imagine, without having had that technology and that kind disciplined effort how it would have worked, and I think that is probably why it failed within Farmers Home. It is a little bit distressing to hear there is some consideration being given to moving forward or the thought that the FmHA would move forward with an escrow program separate and apart from merging the servicing into a centralized environment, because based on my experience in this business, it just can't work.

Mr. CONDIT. Mr. Campbell, aside from the servicing issues, you articulated very well your concerns about changing the philosophical objectives of Farmers Home, the objectives being to get people into ownership. Do you have any other fears that the USEA reorganization could undermine Farmers Home's role in urban housing in any other way?

Mr. CAMPBELL. Well, no. Basically it goes to having the coverage in the rural places, that by the elimination of those offices, you will leave places that are not covered, and the same problem of trying to reach and deliver the program, that would be a problem, of trying to reach and deliver the program, to the extent you leave those areas uncovered.

Mr. CONDIT. So just a void in that people would not be knowledgeable and participate in the program?

Mr. CAMPBELL. The further you move it away from those people, the less is your ability to deliver that product.

Mr. CONDIT. Do you have any feelings that we ought to do some paring down, just for the economy of scale and the lack of revenue we have here? Is there any appropriate way to do that, in your opinion, or should it just not be done?

Mr. CAMPBELL. Well, I think it should be. My opinions went a bit the other way from where the department is headed now. I thought we maybe ought to have a consolidation of a strong Farmers Home Administration as opposed to a disbursement or a breakup of the agency and a reshaping of the mission of the agency, a renaming of it, perhaps, but a pulling in of RDA into Farmers Home and paring it down that way.

The direction we are now headed down the path toward having with the three agencies, I think makes it a lot more difficult to justify, in cases where you have a majority farm program area or majority housing program area, as to how you actually serve those with this three divisions of the agencies you now will have.

How do you serve the purposes of those proposed three areas in these far-flung rural places with staff levels? If you have got a staff of one, does he do the functions of the other two?

Mr. CONDIT. Could he, and should they?

Mr. CAMPBELL. Well, then I think it gets to be difficult, where you have very different substantive areas that they are dealing with out there. But you often just do not have fully employed staff in the areas.

So to the extent that we have it now where they can do more than one thing, I think you have a better chance of them being fully employed.

Mr. CONDIT. Mr. Murray, could you briefly describe, and we will try to move these along because we have a vote coming up here, but could you briefly describe the current state of the mortgage servicing industry? Is it growing and advancing?

Mr. MURRAY. It is growing, because of the greater securitization of the mortgage market, servicing has become a very important part of that market. Servicing is a very valuable asset, for most mortgage bankers, their servicing portfolio constitutes a good part of their net capital, and the mortgage banking industry, partly due to the tremendous amount of refinancing that has been going on throughout the country in the past 2 or 3 years, has grown significantly.

Mr. CONDIT. Based on your experience and the information you have heard today, do you think there would be an interest in private companies bidding on this work?

Mr. MURRAY. Yes. Yes, I think, as I mentioned, a loan portfolio, the servicing of loan portfolios is a valuable commodity, and one that is very desirable.

I think, as Mr. Watts has testified, the Farmers Home would be challenged in any event to try to take those credits and be able to work with them and service that portfolio.

I am not saying that this would be a prime candidate for mortgage servicers, but it would certainly be of interest to many mortgage servicers, I believe.

Mr. CONDIT. Mr. Murray and Mr. Watts, both, how much would you estimate the cost of creating a state-of-the-art mortgage servicing facility that could handle 690,000 loans? How many employees would it take to operate it and how much would it cost?

Mr. WATTS. I guess I will take that first. That is a big question. I will tell you, we operate our service center at about 160 full-time equivalent employees right now for a portfolio of about 100,000 loans approximately.

My suspicion is it would probably take 600 to 700 people, thereabouts, that is a seat-of-the-pants guess. The incremental costs are smaller as you recognize economies of scale.

In terms of technology, the technology itself is not so costly, quite frankly, certainly the hardware is not costly at all. We talked before about what kind of a system the FmHA might use. We run an AS400, it is a relatively inexpensive machine which I call a cross between a mainframe and a PC. It is not a mainframe at all, however. We just upgraded ours. It cost $200,000. We can probably service 350,000 loans on it.

The time to develop the technology is really the key issue. There was a statement made by the gentleman from the Farmers Home earlier that they were going to go out to a third party vendor, one of the major ones, I believe. We talked to the largest software vendor in America in the mortgage business a number of years ago, and we were considering putting our loans on to their system. They came to our shop and did an exhaustive study of our technology, and they told us with our full help it would take about 4 years to develop the technology.

So it is really more of an issue of time than it is cost. The technology cost I would guess—I would be surprised if it cost $10 million to develop. Certainly there would be ongoing annual usage charges. I would be very surprised if it was that expensive to develop the technology. It is the time that is required and focusing the expertise.

So I am guessing 600 to 700 staff, perhaps $10 million for the technology, on the high side. Just by the by, though, there was also a statement made earlier by Mr. Duan that our cost to service was $280 per loan. I don't know where that came from. Our costs aren't even close to that.

I am not at liberty to tell you our cost, but we could certainly service it for less than half of what Farmers Home does and that would include serious services.

Mr. CONDIT. Mr. Murray, do you want to take a stab at that?

Mr. MURRAY. That is really not my business, Mr. Chairman, so I couldn't—but I could take a stab at it. Portfolios are valuable; 25 basis points is considered a reasonable servicing fee for a home mortgage.

So you could take 25 basis points for the total portfolio, and that would give you a very rough figure of what the ongoing costs of servicing would be. Again, that is just a very rough—there are experts in the field who could come up with a much more precise figure. But I am sure that figure is available.

As far as starting up a system, I can tell you, my experience at Fannie Mae was that it is a never-ending process. We went from one system to another, and it is about—it can be a 5 or 6-year cycle. And that is the situation in the case of Fannie Mae, where they were not actually servicing the portfolios, but they had to have systems in place that could—under which they could monitor the servicing of the portfolio by others. So there is a significant amount of lead time, although I think now the state of the technology is so high that it probably is no longer a question of 5 years, it may be 2 to 3 years, but it does take time.

Mr. CONDIT. Thank you.

Mrs. Thurman.

Mrs. THURMAN. Mr. Campbell, let me ask you a question. When we heard testimony earlier, and because of this centralization issue, they talked about going out in mobiles and putting a show on the road; does that help at all?

Mr. CAMPBELL. I don't think it works, actually. I think that what happens is you have to have people out there working with that clientele, who understand that area, are familiar with it, and get loans made.

Maybe the approach is to have some consolidation of county offices where you have a reduced radius in which people have to travel, so that they stay within 60, 70 miles or so, so they can get to all of that area that they are served.

But you have a timing problem when people are available. Some of that is tried now, where there are dates on which offices are served where they are only there on certain days of the week.

Mrs. THURMAN. Mr. Chairman, do we want to go vote——

Mr. CONDIT. We may submit questions and we will move out of here in a few minutes.

Mrs. THURMAN. Mr. Watts, are you familiar with the PLAS computer system that USDA is using for servicing, and do you think this system is upgradable to perform the tasks we have been discussing today?

Mr. WATTS. I am not intimately familiar with that system. PLAS, in my experience, is not a servicing system. It is more of an accounting system. It has the ability to apply payments, but it doesn't have the ability to do any of the servicing tasks, particularly in escrow, but as well, it doesn't provide the customer service type of information the borrower rights or the assistance program data is not resident on that system.

So I would say on my judgment, based on what I know, and again, I am not intimately familiar with it, that it is probably not upgradable.

Mrs. THURMAN. Maybe to all of you, the Federal Government has many different housing programs, and I think that the mortgage industry, as I have seen it, as many of us have seen it, has changed dramatically, and government may not have kept up with all of those changes.

What I would like for you to do is share some of your thoughts on what you think the role of the government in homeownership programs in the 1990's should be.

Mr. MURRAY. I will make a stab at it, to begin. I think the Federal Government's role is much better in guarantee mode than in a direct lending mode. I think direct lending modes historically have had a very difficult time.

I think moving the servicing to a central servicer would certainly be an improvement. But just philosophically, I think housing, certainly where we are at in our finance system for housing is remarkable today, considering the liquidity, the ability to refinance, which wasn't there 10 years ago before the private sector. And when I say private, I put that in quotes, because Fannie, Freddie, Ginnie all have government relations, but they really are in the private sector, using the private sector as much as possible.

And I think agriculture, unfortunately, is often taken care of too well. And I think the Department of Agriculture is kind of typical of the fact that rural areas really haven't been brought into the 20th century in terms of technology, in terms of liquidity for the farmers and other things.

Farmer Mac is an attempt in the farm credit system to provide alternatives to the farm credit system. When the farm credit system collapsed, much of the problem with the farm credit system was because they were too sheltered from the real world.

And I think to the extent you give in to the temptation to shelter the farmer, to guide him and to help him, you cripple him. And I think that is a historical problem with agriculture generally, and I think agriculture finance specifically.

Mr. WATTS. I would agree. I also believe that the role of the government in the 1990's and going forward is more—is better served perhaps as a guarantor of loans than as a loan maker, per se, and loan servicer.

The example, very successful examples of Fannie Mae, Freddie Mac, Ginnie Mae, are probably the most instructive. The private sector brings the best that it has to bear when having the umbrella of the government guarantee, makes the product much more sellable, much more fungible, perhaps, than it would otherwise be.

As a side comment, the Farmers Home has a guarantee program. We are very much involved in this program, by the way. We have an active correspondant program with correspondant's in 38 States and growing. We have originated approximately $50 million over the last 8 months of this product. And it is growing in leaps and bounds. It is a good example because Farmers Home themselves has told us in terms of dollar cost, it costs them—and I am going to be probably a little off on these numbers—about $1.35 per $100 loaned for the guarantee program versus somewhere in the neighborhood of $24 for their direct lending program. Again, I am sure that I am not exactly correct, but that differential in cost is huge between the direct program and the guarantee program. It reflects the greater efficiency of the private sector.

Also, I might add, the guarantee program delinquency rate in our own portfolio is less than one-half of 1 percent. It is my understanding that in the 2 years the Farmers Home guarantee program has been in existence, only 12 claims have been filed. It is early on, it is only 2 years into the program, but I think it reflects that if a program is well administered in the private sector and backed with a government guarantee, even a program that with financing at 100 percent loan to value can be successful.

I too feel that the government is much better suited as a guarantor.

Mr. CONDIT. Thank you, Mr. Watts.

I should have advised all of you, we have approximately 5 minutes to cast a journal vote. Mr. Campbell, I apologize, but I am going to ask you to be brief in your statement.

I believe you touched on this. We will leave the record open on this question as well.

Mr. CAMPBELL. I think the role is really to facilitate and work with the private sector more in that, but there is a gulf there between those people who it is most difficult to serve.

The number that someone gave earlier, $16,000 or so, income strata for the guarantee program tends to be higher than that. When you get down to the other area, you have, for example, the need to do some creative underwriting with those borrowers. For example, there may be would-be problems, and they are getting financing that could be explained or that someone has to work with them, and that is the reason for the supervised credit that there is a process of loan making that is different from those lenders who

would try to do it under the guarantee program, that you won't have in that system.

And you will naturally have to float up to a higher income strata. So the government as the final arbiter of how you provide decent housing plays a very important role here. But I do think it really has to try to bring in a whole new set of players, nonprofits and banks and others at the State levels.

Mr. CONDIT. Thank you, Mr. Campbell. A final word, Mrs. Thurman?

Mrs. THURMAN. Yes, I agree.

Mr. CONDIT. Thank you very much, gentlemen. We appreciate your being here today. You have done a service to the committee. This meeting is adjourned.

[Whereupon, at 12:20 p.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.]

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